

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS  
FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Petition of  
Minnegasco, a Division of NorAm  
Energy Corp., for Authority to  
Increase Its Rates for Natural  
Gas Service in Minnesota

FINDINGS OF FACT,  
CONCLUSIONS OF LAW  
AND RECOMMENDATIONS

The above-entitled matter came on before Administrative Law Judge Allen E. Giles (the "ALJ") for evidentiary hearings on January 22-23, 25-26 and 29-31, 1996 in St. Paul, Minnesota.

The parties to the proceeding consisted of the following: Minnegasco, a Division of NorAm Energy Corp. ("Minnegasco", "the Company" or "the Utility"); the Minnesota Department of Public Service ("the Department" or "DPS"); the Office of the Attorney General - Residential Utilities Division ("OAG"); Minnesota Alliance for Fair Competition ("MAC"); Minnesota Energy Consumers ("MEC"); the Suburban Rate Authority ("SRA"); Utilicorp United, Inc. ("Utilicorp"); Energy CENTS Coalition ("ECC"); Northern Natural Gas Company ("Northern Natural"); and Minnesota Propane Gas Association ("MPGA").

Appearances were made by the following:

Paul T. Ruxin, of the firm of Jones, Day, Reavis & Pogue, North Point, 901 Lakeside Avenue, Cleveland, Ohio 44114, and Brenda A. Bjorklund and Douglas W. Peterson, Minnegasco, 800 LaSalle Avenue, PO Box 59038, Minneapolis, Minnesota 55459-0038, appeared for Minnegasco.

Dennis Ahlers, Kathy McGill and Brent Vanderlinden, Assistant Attorneys General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130, appeared for the Department.

Eric Swanson and Anu Seam, Assistant Attorneys General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130, appeared for the OAG.

Pam Marshall, 1916 Second Avenue South, Minneapolis, Minnesota 55403, appeared for the ECC.

James M. Strommen, of the firm of Holmes & Graven, 470 Pillsbury Center, 200 South Sixth Street, Minneapolis, Minnesota 55402, appeared for SRA.

Laurance R. Waldoch, of the firm of Lindquist & Vennum, 4200 IDS Center, 80 South Eighth Street, Minneapolis, Minnesota 55402-2205, appeared for the MPGA.

Lon Stanton, ENRON, 1600 West 82nd Street, Suite 210, Minneapolis, Minnesota 55431, appeared for Northern Natural.

Robert Harding, Clark Kaml, and Louis Sickmann, Rates and Financial Analysts, 121 Seventh Place East, Suite 350, St. Paul, Minnesota 55101, appeared in a neutral capacity for the Minnesota Public Utilities Commission ("MPUC" or "the Commission").

The record for this decision closed on March 22, 1996, upon receipt of the Department's correspondence correcting its revenue requirement calculation.

Notice is hereby given that, pursuant to Minn. Stat. § 14.61, and the Rules of Practice of the Public Utilities Commission and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed within 20 days of the mailing date hereof with the Executive Secretary, Minnesota Public Utilities Commission, 350 Metro Square, 121 Seventh Place East, St. Paul, Minnesota 55101. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties. If desired, a reply to exceptions may be filed and served within ten days after the service of the exceptions to which reply is made. Oral argument before a majority of the Commission will be permitted to all parties adversely affected by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply, and an original and 14 copies of each document should be filed with the Commission.

The Minnesota Public Utilities Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept or reject the Administrative Law Judge's recommendation and that said recommendation has no legal effect unless expressly adopted by the Commission as its final order.

### STATEMENT OF ISSUES

Whether Minnegasco should be permitted to increase its rates for natural gas service within the State of Minnesota by \$24,349,000 in annual revenues, which it requested, or by some lesser amount, or not at all? If so, what should the amount be and how should it be apportioned among various classes of ratepayers. In addition, while addressing these overall questions, the Commission has directed that the following issues be addressed:

Is the Test Year revenue increase sought by the Company reasonable or will it result in unreasonable and excessive earnings by the Company; is the Rate Design proposed by the Company reasonable; are the Company's proposed Capital Structure and Return on Equity reasonable.

Finally, the Commission in its Notice and Order for Hearing also directed the parties to make a record on the following issues and refrain from including them in any proposed settlement:

1) The Company's incentive compensation program; 2) Minnegasco's use of an imputed, hypothetical capital structure rather than an independent, actual capital structure; 3) The Midwest Gas acquisition adjustment; 4) The Company's low income discount program; 5) Manufactured gas plant cleanup costs; 6) Plant-related expenses to serve new customers including the ongoing requirements of maintaining and upgrading Minnegasco's distribution system; 7) Increased computer costs; and 8) The use of NorAm's consolidated tax calculations in the rate case.

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

## FINDINGS OF FACT

### I. PROCEDURAL BACKGROUND

#### A. Notice and Hearings

1. On August 11, 1995, Minnegasco filed a petition with the Commission seeking authority to increase its Minnesota retail electric rates by \$24,349,000 or 4.2 percent on an annual basis. The Company also filed a petition for interim rates in which it sought to increase its present revenues by \$18,862,000 or 3.3 percent. (Minn. Stat. § 216B.16, subd. 1 (1994)).

2. By Order dated October 4, 1995, the Commission accepted Minnegasco's filing for a general rate increase, suspended the proposed rates, and initiated an investigation to determine the reasonableness of the proposed rates. (Minn. Stat. § 216B.16, subd. 2 (1994)).

3. On October 4, 1995, the Commission issued a Notice of and Order for Hearing directing that a contested case proceeding be held on the reasonableness of the rate changes proposed by Minnegasco pursuant to the Administrative Procedure Act, Minn. Stat. § 14.57-14.62 (1994).

4. On October 10, 1995, the Commission issued an interim rate Order (Minn. Stat. § 216B.16, subd. 3 (1994)) authorizing Minnegasco to collect as interim rates an increase of \$17,772,000 in additional revenues or 3.12 percent of revenues over current rates for service rendered beginning October 10, 1995. Interim rates are

presently being collected subject to refund of any revenues collected in excess of the final rates to be determined by the Commission.

5. On October 18, 1995, a prehearing conference was held at the Commission's Large Hearing Room in St. Paul, Minnesota. The following were made parties to this proceeding: The Minnesota Department of Public Service, the Office of the Attorney General-Residential Utilities Division, Minnesota Alliance for Fair Competition, Minnesota Energy Consumers, the Suburban Rate Authority, Utilicorp United, Inc., Energy CENTS Coalition, Northern Natural Gas Company and Minnesota Propane Gas Association. Northern Natural appeared at the hearings but sponsored no witnesses. MEC, MAC, and Utilicorp did not appear at the hearing nor did they sponsor any witnesses.

6. On November 22, 1995, the Administrative Law Judge issued a Prehearing Order establishing a hearing schedule and procedural guidelines governing the conduct of the case. The Prehearing Order scheduled informal public hearings which were held at the following locations on the dates indicated:

<u>Date</u>	<u>Time</u>	<u>Location</u>
December 5, 1995	7:00 p.m.	Bloomington
December 6, 1995	1:30 p.m.	Minneapolis
December 6, 1995	7:00 p.m.	Coon Rapids
December 13, 1995	1:30 p.m.	Mankato
December 14, 1995	8:00 p.m.	Brainerd

The Prehearing Order also scheduled formal evidentiary hearings from January 18, 1996 to February 2, 1996 at the Commission's Large Hearing Room in St. Paul, Minnesota.

B. Late-Filed Exhibits

7. During the evidentiary hearings, Commission staff requested that the Department provide updated schedules on the sales forecast issue based on the terms of the proposed settlement. Minnegasco and the Department discussed this request and Minnegasco prepared and filed on February 26, 1996 the following documents: Exhibit 126 which is a non-proprietary exhibit containing test year sales volumes and present revenue by customer class as updated by the settlement; and Exhibit 127 which contains similar information but is proprietary because it contains information on market rate customers. Exhibits 126 and 127 are received as evidence in this proceeding.

II. PARTIES

A. Minnegasco

8. Minnegasco is a natural gas distribution company headquartered in Minneapolis, Minnesota. The Company is engaged in the sale and distribution of natural gas to some 620,000 customers in approximately 200 communities in Minnesota. The largest metropolitan areas served are Minneapolis and its west metro suburbs. Minnegasco previously served portions of Nebraska and South Dakota, but in early 1993, the Nebraska operations were sold to Utilicorp and in mid-1993, the South Dakota properties were exchanged for Midwest Gas Company's Minnesota operations. Minnegasco maintains its principal office in Minneapolis, Minnesota and has other offices throughout its Minnesota service territory.

9. Minnegasco purchases the vast majority of its gas directly from producers. It serves its Minnesota customers with natural gas transported by the Northern Natural Gas and Viking Pipeline systems. The Company's gas distribution system consists of over 9,800 miles of mains. Minnegasco provides natural gas service according to a Schedule of Rates for the following customer rate classes: Residential, Commercial/Industrial, Market General Service, Small Volume Dual Fuel and Large Volume Dual Fuel.

10. Minnegasco has provided natural gas service in the State of Minnesota for over 125 years beginning in the 1870s as the Minnesota Gaslight Company. In 1990, Minnegasco was a wholly-owned subsidiary of a holding company, Diversified Energies, Inc., whose business activities included natural gas distribution, oil and gas exploration and production and radio communications. On November 29, 1990, Minnegasco became an operating division of NorAm Energy Corp., formerly known as Arkla, Inc. after Diversified Energies, Inc. merged into NorAm.

11. NorAm Energy Corp., headquartered in Houston, Texas, is a publicly-owned, diversified natural gas company with integrated operations in natural gas distribution, transmission, and, until recently, oil and gas exploration and production. In terms of customers, NorAm's natural gas distribution units, including Minnegasco, represent the third largest gas distribution system in the United States, serving over 2.7 million customers in seven central U.S. states, extending from the Canadian border to the Gulf of Mexico. As a result of depressed pipeline transportation margins, low spot gas prices, unusually warm weather, changes in accounting methods, extensive use of debt for acquisitions, and settlement of take-or-pay claims have combined to drain NorAm's cash flow and severely limit its financial flexibility. In 1992, NorAm recorded a loss of over \$236 million, and since 1990 its common equity ratio has eroded from approximately 42% to 26% at the end of 1994. MGC Ex. 1 at 9-13.

12. This is the third general rate case filed with the Commission by Minnegasco since 1992. In the other dockets, GR-92-400 and GR-93-1090, the Commission approved rate increases of \$12.9 million effective August 12, 1993 and \$7.1 million effective June 1, 1995, respectively. Minnegasco's Director of Regulatory

Services, Tracy Bridge, indicates that the reasons for the current rate increase application are the following cost increases: plant-related expenses, environmental cleanup costs, cost of capital, CIP/DSM expenses, inflation-related expenses, Midwest acquisition adjustment, computer and other services, and the low income discount rate.

B. Participating Intervenors

1. The Department of Public Service

13. The Minnesota Department of Public Service has an affirmative obligation to participate in proceedings before the Commission. The Department has an obligation to investigate and enforce, on behalf of the general public interest, the standards and requirements imposed on a public utility by the Minnesota Public Utility Act. The Department intervenes as a matter of right in proceedings before the Commission pursuant to Minn. Stat. § 216A.07 (1994).

2. The Attorney General's Office

14. Attorney General Hubert H. Humphrey III is statutorily charged with representing and furthering the interests of residential and small business utility customers in matters before the Minnesota Public Utilities Commission which involve utility rates and adequacy of utility services to residential and small business utility consumers. Minn. Stat. § 8.33, subd. 2 (1994). The Attorney General is entitled to intervene as of right and to participate as an interested party in matters pending before the Commission. Minn. Stat. § 8.33, subd. 3 (1994).

3. The Suburban Rate Authority

15. The Suburban Rate Authority is an association of 32 municipal corporations in the State of Minnesota organized under Minn. Stat. § 471.59. Most member municipalities of the SRA are within the Minnegasco gas service area. The SRA has previously been an active participant in numerous proceedings involving Minnegasco before the Commission. The member municipalities of the SRA, through the duly elected governing body of each, collectively and individually, have a direct and substantial interest in the rates that may be authorized by this proceeding. Due to the suburban Twin City location of SRA members, the SRA represents interests which often cannot be adequately advanced by any other person, group or public agency.

4. Energy CENTS Coalition

16. Energy CENTS Coalition is a membership-based organization dedicated to ensuring affordable utility service and citizen participation in energy-related decisionmaking. The organization represents low-income utility ratepayers who are adversely and disproportionately affected by utility rate increases. Energy CENTS

Coalition has a particular interest in the impact of residential rate increases on the ability of low income customers to obtain affordable and safe gas service, particularly in the winter. The organization serves as an advocate for low-income customer assistance programs that may be used to offset residential rate increases.

5. Minnesota Propane Gas Association

17. The Minnesota Propane Gas Association (MPGA) is an organization whose members supply propane and natural gas to customers across Minnesota and who compete directly with Minnegasco in thinly populated or low fuel use areas. MPGA has intervened in this proceeding for the purpose of focusing the attention of the Commission upon line extensions by Minnegasco outside of its service area that are subsidized by ratepayers. MPGA seeks to avoid damage to the competitive position of its members as a result of expansions into thinly populated and low fuel use areas of gas service by Minnegasco which the MPGA believes are improperly subsidized by ratepayers.

III. PROOF OF REVENUE REQUIREMENTS

18. A major issue in this rate proceeding is what level of revenues is required by Minnegasco for the provision of gas distribution service in Minnesota. A utility's revenue requirement is the level of revenues necessary for delivery of efficient, adequate and economical service that at the same time maintains or preserves a utility's sources of capital. Northwestern Bell Telephone Company v. State, 216 N.W.2d 841 (Minn. 1974). Whether a utility's revenues are adequate is determined by closely examining a utility's operating experience during a test period having representative levels of revenues, expenses, rate base and capital structure. Northwestern Bell Telephone Company v. State, 253 N.W.2d 815 (Minn. 1977). As a utility seeking a rate change, Minnegasco has the burden of establishing that its revenue collections during the test period are inadequate to maintain efficient delivery of service and inadequate to preserve Minnegasco's sources of capital. Minn. Stat. § 216B.16, subd. 4 (1994).

19. The Minnesota Supreme Court has described a public utility's burden of proof as follows:

A utility seeking to change its rates has the burden of proving by a preponderance of the evidence that its proposed rate change is just and reasonable. Minn. Stat. § 216B.16, subd. 4 (1986). Preponderance of evidence is defined for ratemaking purposes as whether evidence submitted, even if true, justifies the conclusion sought by the petitioning utility when considered together with the Commission's statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished with services at reasonable rates.

Petition of Minnesota Power and Light Company, 435 N.W.2d 550, 554 (Minn. App. 1989).

20. The Administrative Law Judge will make specific findings and conclusions on all issues contested by the parties. Specific findings and conclusions will also be made with respect to the issues the Commission has directed for evaluation, regardless of whether the issues are contested.

#### IV. TEST YEAR

21. Test Year data should be representative of normal utility operations that are expected to exist when the proposed rates will be in effect. Minnegasco has proposed October 1, 1995 - September 30, 1996 as the Test Year period to be used as the basis for determining its revenue requirements for providing natural gas service. Minn. Rules, pt. 7825.3100, subp. 17 suggests that any representative 12-month period "selected by the utility" can be used as the test period. The Company's proposed Test Year to be used for evaluating representative levels of rate base, operating income and capital structure is found to be reasonable.

#### V. THE OFFER OF PARTIAL SETTLEMENT

##### A. Explanation of Settlement and Stipulated Issues

22. During the course of their preparation for the contested case hearings, Minnegasco and the Department held numerous settlement discussions and on January 25, 1996 entered into the Offer of Partial Settlement (the "Offer") which settled a number of revenue requirement issues and also set forth both a stipulation of facts and recommended decision on certain revenue requirement issues that the Commission had directed not be in a settlement. The Offer also described certain issues which were not in dispute between the parties. The Offer was entered into the record as MGC Ex. 26. It was adopted by both the Department and Minnegasco, but not by any of the other parties.

23. The distinction between the settled issues and stipulated issues is both significant and substantive. The agreement on the settled issues is expressly conditioned upon its acceptance by the Commission in its entirety without modification, except as revenue requirement or rate design effects may be changed as a result of the Commission's resolution of the stipulated or disputed issues. Pursuant to Minn. Stat. §216B.16, subd. 1(a), if the Commission otherwise modifies this Settlement in a final Order After Reconsideration, the parties have ten (10) days in which to reject the modification. If any party rejects the modification, the parties have agreed that this Settlement shall be null and void and shall not constitute any part of the record in this proceeding. In such event, the parties have agreed that the hearings should go forward promptly upon all settlement matters raised in the testimony of the parties to the proceeding and that all parties be permitted to argue their positions with respect to such issues to the Commission in post-



hearing briefs and, if requested or permitted by the Commission, oral argument. MGC Ex. 26, p. 18.

24. The parties to the Offer did not settle any of the eight issues that the Commission requested not be part of a settlement as listed in the Commission's October 4, 1995 Order. However, on three of these issues: line extensions, environmental expenses, and the low-income discount rate, the parties to the Offer stipulated as to the facts and recommended a decision. A Commission modification to the decision recommended on these issues would not require further evidentiary hearings. MGC Ex. 26, pp. 14-15.

25. The impact of the Offer as filed (including both the settled issues and stipulated issues) reduces Minnegasco's original filed operating expenses by \$3,619,016 and rate base by \$3,073,662. MGC Ex. 26, p. 16. In addition, a subsequent agreement between Minnegasco and the Department to settle economic development expenses further reduces operating expenses by \$76,403. MGC Ex. 125. The total reduction in operating expenses is thus \$3,695,419.

26. The parties to the Offer agreed that the Commission's decision on the stipulated and disputed issues will not affect the reasonableness of the results of this Settlement. The parties recognized that the Commission's resolution of these remaining issues will have an impact on the Company's revenue requirement. MGC Ex. 26, p. 3.

27. The ALJ finds that there is sufficient evidentiary support for the Offer in the pre-filed testimony, schedules, hearing transcripts and additional material attached to and made a part of the Offer. The parties also made their witnesses available at the evidentiary hearings to address issues contained within the Offer for purposes of further supplementing the record. MGC Ex. 26, p. 4.

28. Specific findings on each issue addressed in the Offer are set forth in the following paragraphs.

B. Settled Revenue Requirement Issues

1. Advertising

29. Minnegasco requested recovery of \$782,512 in FERC Account 9090, Informational and Instructional Advertising; \$109,978 in FERC Account 9130, Advertising Expenses; and \$130,735 in FERC Account 9300, General and Institutional Advertising, for a total of \$1,023,225 in advertising expenses. The Department recommended that the Commission disallow \$51,786 from FERC Account 9090 and that all of the amounts in FERC Accounts 9130 and 9300 be disallowed, for a total recommended disallowance of \$292,499. MGC Ex. 26, p. 4.

30. Minnegasco disagreed with the Department's recommendations for Accounts 9090 and 9130 but agreed to reduce expenses for Account 9300 by \$130,201.

The Department's final recommended disallowances were \$35,153 for Account 9090, the full \$109,978 for Account 9130 and Minnegasco's recommended \$130,201 for Account 9300, for a total of \$275,332. MGC Ex. 26, pp. 4-5.

31. The parties agreed to disallow \$35,153 for Account 9090, \$54,989 for Account 9130 and \$130,201 for Account 9300, for a total reduction in revenue requirements of \$220,343. MGC Ex. 26, p. 5.

## 2. Marketing and Customer Service Expenses

32. Minnegasco requested the recovery of the costs of certain of its marketing and customer service related programs. The Department initially recommended that \$1,024,587 of those costs be disallowed and subsequently revised the figure upward to \$1,389,615. MGC Ex. 26, p. 5.

33. After Minnegasco provided the Department with additional material regarding various marketing and customer service related costs, the parties agreed that the total disallowed marketing expenses would be \$1,069,150, as adjusted to reflect the allowance of general and administrative costs that do not relate to marketing programs, as detailed in the Offer. MGC Ex. 26, p. 6.

## 3. General Inflation

34. Minnegasco's original filing reflected the impact of inflation on its costs between the 1994 base year and the test year ending September 30, 1996. Minnegasco proposed a general inflation factor of 5.75% based on index information available at the time of the filing. The Department developed a lower inflation factor using different information and proposed that the inflation factor be updated for subsequently available index information. MGC Ex. 26, p. 6.

35. Minnegasco agreed to use an updated index for developing an inflation factor, and an inflation factor of 4.05% was proposed, based on later information. The parties agreed to this inflation factor, which reduces Minnegasco's revenue requirement by \$345,398. MGC Ex. 26, pp. 6-7.

## 4. Paper and Paper-with-Printing Inflation

36. Minnegasco's original filing included a 59.25% inflation factor for computer and copy machine paper. The Department responding by recommending a paper inflation factor of 44.63% and a paper-with-printing inflation factor of 33.5%. MGC Ex. 26, p. 7.

37. Minnegasco agreed with the Department's recommendations with regard to computer paper and paper-with-printing inflation factors, but recommended an inflation

factor of 87.1% for copy machine paper costs. The Department continued to recommend an inflation factor of 44.63% for both copy and computer paper costs.

38. The parties agreed to a paper inflation factor of 44.63% for both copy and computer paper and a paper-with-printing inflation factor of 33.5%. The agreed upon factors reduce Minnegasco's revenue requirements by \$71,535 and \$26,509 respectively, for a total adjustment of \$98,044.

#### 5. Telecommunications Inflation

39. Minnegasco's original filing requested an inflation factor of 13.52% for certain telecommunications expenses. The Department recommended that the general inflation factor be applied to the telecommunications expenses. MGC Ex. 26, p. 8.

40. Minnegasco then modified its original proposal and requested a revised telecommunications inflation factor of 6.67%. The Department responded by recommending that no inflation be allowed for telecommunications costs. MGC Ex. 26, p. 8.

41. The parties agreed that no inflation would be added for the telecommunications costs at issue. This agreement reduces Minnegasco's revenue requirements by \$91,455. MGC Ex. 26, p. 8.

#### 6. Software and Tuition Inflation

42. Minnegasco requested an inflation factor of 13% for software maintenance and tuition expense. The Department recommended using the general inflation factor of 4.05% for these expenses. MGC Ex. 26, p. 8.

43. The parties agreed to use the general inflation factor of 4.05% for software maintenance and tuition expenses. This agreement reduced Minnegasco's revenue requirements by \$33,918 for software maintenance and increased tuition expense by \$415. MGC Ex. 26, pp. 8-9.

#### 7. Other Inflation Adjustments

44. In addition to its specific inflation factor recommendations, the Department recommended inflation adjustments to outside legal expenses related to the "cost allocation case," Docket No. G-008/C-91-942, CIP expense, and advertising and marketing expense. Minnegasco recommended that inflation adjustments to outside legal expense and to advertising and marketing expense should be based on the revised general inflation factor of 4.05%. Minnegasco further indicated that inflation adjustment to CIP expense was inappropriate. MGC Ex. 26, p. 9.

45. The parties agreed to use the revised general inflation factor of 4.05% for outside legal expense and advertising and marketing expense, and that no inflation adjustment is needed regarding CIP expenses. MGC Ex. 26, p. 9.

#### 8. Rate Case Expenses

46. Minnegasco initially proposed the recovery of its estimated 1995 rate case expenses of \$1,130,945 be amortized over two years, with an "unamortized" amount to be included in the rate base. Additionally, Minnegasco proposed that its unamortized 1993 rate case expenses of \$389,714 be recovered over a two year period with an "unamortized" amount included in the rate base. MGC Ex. 26, pp. 9-10.

47. The Department proposed the following: that \$950,000 was an appropriate amount for Minnegasco's total rate case expenses and \$475,000 as the "normalized" annual rate case expense; this expense be reduced by 9% for costs associated with unregulated aspects of Minnegasco's operations; and that recovery of costs associated with the last rate case be disallowed. MGC Ex. 26, p. 10.

48. The parties agreed that an adjusted normalized annual level of rate case expenses of \$446,500 would be reflected in rates determined in this case. This level was obtained by using the Department's proposed level of \$475,000, reduced by an agreed upon 6% to reflect unregulated operations. The parties also agreed that one-half of the previous rate case's expenses, or \$194,857, be used to reduce the interim rate refund ultimately approved in this case. The total of these agreed upon adjustments reduced Minnegasco's test year operating expenses by \$313,830 and test year rate base by \$668,177. Finally, the parties agreed that Minnegasco may request authorization to defer rate case expenses in excess of \$446,500 in any year to subsequent periods for accounting purposes only, so long as both any deferred amounts will not become a claim for recovery of these expenses in future rate cases and it is understood that the parties have not agreed upon whether General Accounting Principles permit this type of deferred accounting. MGC Ex. 26, pp. 10-11.

#### 9. Gas Leaks and Winter Residential Leak Surveys

49. Pursuant to the Commission's Order, Minnegasco excluded certain costs associated with gas leak checks from its test year in this case. Since this Order is currently under review by the Minnesota Supreme Court, Minnegasco offered revised figures on the technician costs, including leak check costs. MGC Ex. 26, p. 11.

50. The Department and Minnegasco then supplied information to each other which corrected calculations and assumptions which included consideration of the winter residential leak survey issue. MGC Ex. 26, p. 11.

51. The parties agreed to reduce Minnegasco's revenue requirement by \$110,773 for service technician expenses. MGC Ex. 26, p. 11.

#### 10. Sales Forecast

52. Minnegasco forecasted a test year sales volume of 136.845 Mdt before curtailment. The Department, using different forecasting techniques, proposed a test year sales volume of 142.343 Mdt before curtailment. This figure was reduced by 1.019 Mdt in the Department's surrebuttal testimony. MGC Ex. 26, pp. 11-12.

53. The Department accepted Minnegasco's curtailment method, and Minnegasco suggested several changes to the Department's data in its rebuttal evidence. MGC Ex. 26, p. 12.

54. Based on the actual number of Minnegasco customers served at November 30, 1995, which was less than originally anticipated, the parties agreed to reduce the Department's forecast of sales volume in the test year by 1.017 Mdt. This had the effect of reducing Minnegasco's revenue requirement by \$1,206,755. MGC Ex. 26, p. 12, schedule 4.

#### 11. Revenue from Curtailment Penalties

55. The Department recommended that revenue from curtailment penalties be imputed in test year revenue or flowed through to firm customers through the PGA true-up. Minnegasco disputed the recommended amount of imputed income and suggested curtailment penalty revenue be flowed through to customers by the monthly PGA. MGC Ex. 26, p. 12.

56. The Department agreed with this recommendation and the parties agreed to flow through all curtailment penalty revenue to firm customers through the true-up factor in the monthly PGA. MGC Ex. 26, p. 13.

#### 12. Telemetry Equipment

57. Minnegasco included certain telemetry equipment in the test year related to tariff changes proposed in Docket No. G-008/M-95-216, which was approved by the Commission on December 7, 1995. The Department recommended that the telemetry equipment be removed from the test year, based on the Commission approval of the tariff changes. MGC Ex. 26, p. 13.

58. The parties agreed to remove the telemetry equipment and related depreciation expense from the test year. This reduces depreciation expense by \$51,765, general plant and rate base by \$875,000, accumulated depreciation reserve general plant

by \$33,915, and increases accumulated deferred taxes and rate base by \$45,237. MGC Ex. 26, p. 13.

### 13. Economic Development Costs

59. Minnegasco's original filing included \$118,161 of proposed test year economic development costs. The Department recommended a disallowance of all of Minnegasco's proposed test year economic development costs. In response, Minnegasco indicated that certain economic development activities were cost-beneficial and, based on this information, the Department recommended that Minnegasco recover \$12,500 of economic development expenses. MGC Ex. 125.

60. The parties discovered that \$29,258 of expenses had been recommended for disallowance by the Department as both advertising expenses and economic development expenses. To correct for this double-accounting, the parties agreed to reduce the disallowance for economic development expenses from the \$105,661 recommended by the Department in surrebuttal to \$76,403. MGC Ex. 125.

#### C. Stipulated Revenue Requirement Issues:

##### 1. Line Extensions

61. The Department proposed that several deductions be made from Minnegasco's FERC Account 376 in connection with Minnegasco's decision to expand its lines into certain areas not previously served. Minnegasco responded by clarifying several issues that had been raised. This caused the Department to modify its original proposed adjustments. MGC Ex. 26, p. 14.

62. The parties stipulated that the Department's final proposed reduction of \$949,561 in FERC Account 376 and a reduction of Net Distribution Plant of \$628,573 be adopted. MGC Ex. 26, p. 14. The ALJ finds that this stipulation should be adopted.

##### 2. Environmental Costs

63. Minnegasco proposed to recover a "normalized" annual level of environmental clean-up expenses of \$6,970,000. MGC Ex. 3, p. 28; MGC Ex. 11, Schd. 13, p. 2. The Department agreed that this is the appropriate test year expense. DPS Ex. 85, pp. 8-9. The stipulation also reflects adoption of this figure. MGC Ex. 26, pp. 14-15. The ALJ finds that the stipulation is appropriate and should be adopted.

64. Minnegasco also proposed adoption of an Environmental Tracker and establishment of an Environmental Cost Recovery Charge ("ECRC") to recover the tracker balances. MGC Ex. 28, pp. 80-81. The Department agreed that under the circumstances, the use of such mechanisms would be appropriate in light of the inherent difficulties in

forecasting actual environmental costs and related insurance recoveries. DPS Ex. 85, pp. 11-13. The parties agree that the ECRC should be effective and applied to the tracker balance as of October 10, 1995, adjusted to reflect the allowed test year expenses of \$6,970,000. After considering the fluctuating nature of these costs, the ALJ agrees that the proposed tracker and ECRC are reasonable solutions to the problem of assuring that environmental costs and the recovery of those costs are matched, so that there is neither over- nor under-collection, and should therefore be adopted to be effective (as provided by the parties) as of October 10, 1995.

### 3. Low-Income Discount Rate

65. Minnegasco outlined that it had been selected by the Commission to institute a pilot program in order to determine the impact on customers and the utility of giving a 30 percent discount to certain low-income residential customers. The Commission directed Minnegasco to defer the discounted revenue for determination of the appropriate recovery of the program costs in Minnegasco's next rate case. MGC Ex. 37, pp. 95-96.

66. Minnegasco proposed to recover the deferred revenue with carrying costs, recover the discounted program revenue not received in the test year and amortize the deferred revenue balance over a two year period including an amount to recover the current test year costs of the program. This would result in a total adjustment of \$765,372. MGC Ex. 37, pp. 96-97.

67. Minnegasco proposed establishment of a tracker account which would show approved costs being recovered through rates and the actual costs incurred. This account will also be credited by Minnegasco with any savings identified in future reports to the Commission, which will identify the net costs of the program. Minnegasco also proposed to recover the net costs of the program from residential sales service customers on a per customer basis. MGC Ex. 37, pp. 97-98.

68. The Department agreed that it is appropriate for Minnegasco to recover the net costs of the program and the use of the tracker account to determine costs and savings of the program. DPS Ex. 98, p. 40.

69. The Department also recommended that the tracker apply from the beginning of the pilot to when Minnegasco changes the rates at the end of the program, the September 1995 tracker balance be adjusted for estimated positive saving and actual discounts, the expected discounts during the test year be adjusted for expected attrition, and all firm customers be required to pay for the low-income discount. DPS Ex. 98, pp. 42-46, 51.

70. Minnegasco accepted all of the Department's recommendations, which would result in reductions in rate base of \$31,500 and operating expenses of \$78,000. MGC Ex. 26, p. 15. The ALJ finds that the stipulation is appropriate and should be adopted.

D. Issues Not in Dispute

1. Costs of the Cost Allocation Case, Docket No. G-008/C-91-942

71. No party disputed that test year outside legal expense should be reduced by \$52,025 relating to the costs of the Cost Allocation Case, Docket No. G-008/C-91-942. MGC Ex. 26, p. 15.

2. Good Will Adjustment

72. No party disputed that additional test year revenue should be imputed to good will associated with Minnegasco's home security business. The amount to be imputed is proprietary and is contained in the Department's testimony. MGC Ex. 26, p. 16; DPS Ex. 69, p. 27.

3. Liquefied Natural Gas ("LNG") Sales to Burlington Northern ("BN")

73. No party disputed that \$126,894 should be removed from "Other Revenue," since BN has discontinued its use of LNG as an engine fuel. MGC Ex. 26, p. 16.

4. FAS 106 Funding

74. No party disputed that Minnegasco has complied with the Commission's 1993 Rate Case order on FAS 106 funding and that the 1995 contribution amount is appropriate. MGC Ex. 26, p. 16.

E. Impact of Settled and Stipulated Issues on Cost of Service

75. The foregoing adjustments to cost of service items in the Offer, including the economic development expense issue, reduce the original filed operating expenses by \$3,695,419 and rate base by \$3,073,662. MGC Ex. 26, p. 16; MGC Ex. 125. The ALJ finds that the Offer in its entirety is reasonable, supported by the record and should be adopted.

DISCUSSION

It is important to note the difference and legal significance between the matters settled and those stipulated to. The settlement (issues encompassed in Exhibit 26) is an "all-in-one package" in the sense that, should any part of it be modified or rejected by the Commission, the parties may withdraw the entire settlement and proceed to litigation of all the issues encompassed in the agreement. As to the matters stipulated, the Commission is free to modify or reject each and every part of the Stipulation, based on the balance of



the record, and the parties agree that the Commission's decision on each and every such item is final.

By stipulating on issues the Commission requested they not settle, the parties simply acknowledge that they have no differences (except those noted and litigated separately) in those areas and agree that the Commission can reach a different result, based on the record. In approving this approach the Administrative Law Judge is persuaded that the record is complete and sufficiently extensive, based on pre-filed testimony and cross-examination at the hearing, on each stipulated issue to support the positions agreed to by the parties, and he has found the results stipulated to on these issues to be reasonable and substantially in accord with the findings he would have made independent of the stipulation.

The parties' stipulation on the issues proscribed from settlement by the Commission does not violate the spirit and intent of the Commission's request not to settle. It simply means the parties have no dispute in these areas. Arriving at that end does not mean the parties did not "litigate" the issues. The pre-filed testimony on the issues is extensive -- it simply so happens that the parties did not disagree fundamentally on the issues involved and had proposed the same results in the end. The Commission is free to reject those results and adopt any resolutions supported in the record on these issues.

## VI. CONTESTED FINANCIAL ISSUES

### A. Acquisition Adjustment

76. Minnegasco acquired the Minnesota properties of Midwest Gas ("Midwest") on September 1, 1993 and paid to Midwest \$14,866,423 in excess of the net book value of the properties. MGC Ex. 28, schd. 7. The total annual acquisition adjustment cost to Minnegasco amounts to \$3,091,854. Minnegasco is seeking in this proceeding to recover \$978,685. The Company asserts that this amount equals the benefits to customers resulting from the acquisition.

77. The SRA and the Department both oppose Minnegasco's request for an acquisition adjustment on the basis that the Company has failed to prove any ratepayer benefits and that the savings claimed by Minnegasco is based on speculation.

78. The Judge finds that the acquisition adjustment, like any other rate base asset, must be used and useful to ratepayers. Because Minnegasco has failed to prove that the acquisition provided ratepayer benefits, the acquisition is not used and useful to ratepayers and a recovery should not be allowed.

79. As a result of this conclusion, Distribution Plant Depreciation Expense is reduced by \$503,562 and Property Tax is reduced by \$475,123. DPS Ex. 85 at 7.

## DISCUSSION

In support of its claim for an acquisition adjustment, Minnegasco presented a "macro" assessment of the savings. The macro assessment consisted of a rate/dekatherm-cost/benefit analysis. The cost/benefit analysis estimates that the former Midwest Gas customers could have received savings of \$3,110,740 based on the average of three different 1994 scenarios of rates. This savings is compared to the traditional Minnegasco customers' 1994 increase in costs of \$2,132,055. The difference is an annual non-gas-cost savings of \$978,685. To arrive at this conclusion, Minnegasco's cost/benefit analysis assumes that the former Midwest Gas customers would have had another rate increase in 1994.

Both the Department and SRA sharply disagreed with Minnegasco's cost/benefit analysis and urged the ALJ and the Commission to reject the requested acquisition adjustment. They both argue that Minnegasco has failed to identify ratepayer benefits as a result of the acquisition and that the claimed savings are based on speculation. The ALJ concurs.

The Commission addressed the prerequisites for allowing an acquisition adjustment in the Matter of the Application of Midwest Gas, Findings of Fact, Conclusions of Law and Order, MPUC Docket No. G-010/GR-90-678 (July 12, 1991). The Commission stated as follows:

In determining if an acquisition adjustment may be included in rate base and operating expenses, the Commission must look to the prudence of the investment. Minn. Stat. § 216B.16, subd. 6 (1990) states that the Commission shall give due consideration to evidence of:

[t]he cost of property when first voted to public use, to prudent acquisition costs to the public utility less accumulated depreciation on each. . . . (Emphasis added.)

The prudence of an acquisition is best measured by quantifiable benefits to ratepayers. In this case, Midwest has the burden of showing that ratepayers have received quantifiable savings from the Company's purchase of Northcentral Public Service. Midwest shareholders will be allowed to recover only that amount which the Company can prove equals savings ratepayers have experienced in the 1990 Test Year due to the acquisition.

Id. at 7. The Commission concluded as follows:

In order to recover acquisition costs, a utility must show that it has generated benefits for ratepayers, that those benefits are quantifiable,

and that those benefits would not have been realized by the ratepayers without the acquisition.

Id. at 13. The Commission continued explaining the reasons for its rejection of several of the bases for Midwest's request for recovery, suggesting that there must be ongoing ratepayer benefits not the result of a trend or a course of events. The Commission stated as follows:

The Commission finds that Midwest has not met its burden of demonstrating that its zone transfers will provide a continuing pattern of ratepayer savings or why these transactions should be isolated from other purchasing activity. Neither has Midwest proven that the savings and concessions received from its supplier were not part of a normal business pattern unrelated to the competitive threat created by the Iowa pipeline, or that an ongoing northcentral would not have obtained similar benefits in the absence of an acquisition. The Commission finds that the gas cost savings claimed by Midwest are simply too speculative to ensure ongoing ratepayer benefits.

Id. at 13.

According to the language identified above, the Commission will authorize a recovery for an acquisition adjustment if the following conditions are met:

- (a) a utility must demonstrate benefits to ratepayers;
- (b) that the benefits would not have occurred but for the acquisition;
- (c) that the benefits are quantifiable;
- (d) that the benefits to ratepayers are greater than the cost of the acquisition adjustment, and;
- (e) that there will be ongoing ratepayer benefit realized over time.

Because Minnegasco's "macro" assessment does not attempt to identify ratepayer benefits, the Company's proposal does not begin to satisfy these conditions.

Minnegasco has failed to identify individual cost components of any services for which there could be savings as a result of acquisition of Midwest. For example, in the Midwest Gas case referred to above, Midwest sought an acquisition adjustment based on the consolidation of the two systems resulting in (a) savings in the cost of capital, (b) savings in materials and supplies, (c) savings in general and administrative expenses, and (d) savings in gas costs. Midwest also demonstrated that there were qualitative benefits to customers as a result of the acquisition. These qualitative benefits included, for example, "enhancements in the areas of conservation, the environment, safety, internal

systems and new programs for customers". In the Matter of the Application of Midwest Gas, Report of the Administrative Law Judge, OAH Docket No. 3-2500-5034-2 (May 10, 1991), p. 8.

Minnegasco's "macro" approach does not attempt to show that there are qualitative benefits to customers as a result of the acquisition. Like any other component of rate base, Minnegasco must prove that the property is "used and useful". Minn. Stat. § 216B.16, subd. 6. In this context, Minnegasco must prove that the acquisition provided benefits to customers that would not have been provided without the acquisition. Once the benefits are identified, they must be quantified so that a comparison can be made between the costs of the benefits and the costs of the acquisition. The Judge believes that Minnegasco has failed to prove by a preponderance of the evidence that the acquisition produced benefits to customers, or in other words, the Company has failed to prove that the acquisition was used and useful to customers.

Assuming, however, that Minnegasco's "macro" approach identifies a benefit to customers that allows the argument to get to the issue of quantification, the Judge agrees with the Department's analysis that Minnegasco's quantification is based largely on speculation. The Judge finds that Minnegasco has not only speculated about when Midwest would have filed a rate case, but also about the rates that would have been granted to Midwest. The Judge is also sympathetic to the SRA argument that asks the ALJ and the Commission to consider the equity and reasonableness of imposing costs on pre-acquisition Minnegasco customers when they alone have had increased costs because of the acquisition. The Judge recommends that the acquisition adjustment be denied for these reasons as well.

#### B. Service Extensions

80. In the Notice and Order for Hearing in this rate case and in Docket No. G-999/CI-90-563, the Commission directed Minnegasco, the Department and other interested parties to investigate and address Minnegasco's policies for extension of gas service to new customers. After its investigation, the Department concluded that Minnegasco has not been applying its extension tariffs correctly. DPS Ex. 119 at 5. The Department's analysis indicates that Minnegasco may not have consistently implemented excess footage charges and that, in some instances, projected revenue did not recover the initial investment cost. DPS Ex. 119 at 7. As a result, other ratepayers were inappropriately required to subsidize the service extensions. DPS Ex. 119 at 11. Minnegasco disagreed with the Department's assessment of its application of service extensions to new customers. Minnegasco asserted that its tariffs in effect at the time of the expansion projects allowed it to exercise discretion in its charges to new customers for service extensions. MGC Ex. 32, p. 4; Tr. Vol. 7, pp. 812-13.

81. The Department proposed an adjustment to rate base to make certain that shareholders, not ratepayers, bear the cost of the net present value of the difference between the cost of service and the expected revenue for the four identified expansion

projects. The Department recommended a reduction in Distribution Plant-Main Account of \$949,561. DPS Ex. 119 at 12; DPS Ex. 120 at 7. The Department also recommended an additional adjustment to remove from rate base all uneconomic excess main footage charges that had been waived by the Company since the last rate case. This proposed adjustment results in an reduction to Net Distribution Plant of \$628,573. DPS Ex. 120 at 8. Minnegasco indicated that it will apply the New Area Surcharge Rider (NAS) in future projects where Minnegasco is expanding its service territory. MGC Ex. 22 at 11-12. Minnegasco agreed to the adjustments proposed by the Department. The parties stipulated to these and the Judge has previously recommended that the adjustments be approved by the Commission.

82. The MPGA also asserted that Minnegasco had extended service in instances when it was non-economic to do so. MPGA Ex. 114 at 5-6. MPGA concluded that Minnegasco was not following its own line extension tariffs to serve new customers. Id. at 7-9. MPGA recommended that "all expansions should be considered on a project-by-project basis and the true economic feasibility of each project should not be hidden by averaging the results of all expansion projects." Id. at 9.

83. The MPGA urges the Commission and the ALJ to remove from the Minnegasco rate base "the amount of the subsidies for each of the twenty-three disputed expansion projects". However, the MPGA was not able to specify a precise figure in the record for the rate base deduction which it believes should result from the excess service line footage charge. The MPGA disagrees with the amount stipulated to by Minnegasco and the Department and instead recommends that at a minimum \$1,981,713 should be deducted from rate base and that Minnegasco should be required to provide additional information from which additional wave service line charges can be identified and deleted from the rate base.

84. Because Minnegasco agreed to apply the New Area Service Charge in all future territorial expansions, the Department believed that the problems identified by its investigation would be remedied. The Judge agrees with the Department's assessment and believes that the adjustments proposed by the Department and agreed to by Minnegasco effectively eliminate any uneconomic charges to ratepayers as a result of Minnegasco's new service extensions since the Company's last rate case.

85. The MPGA has requested that the ALJ and the Commission modify Minnegasco's New Area Surcharge Rider so as to eliminate all potential subsidies. MPGA witness William Glahn proposed a number of changes and clarifications to the Company's New Area Surcharge Rider. MPGA Ex. 113 at 3. Minnegasco has moved that the testimony of Mr. Glahn be stricken because it is irrelevant to the issues in this proceeding. Minnegasco argues that the NAS rider was the subject of a recent proceeding in which the Commission issued an Order approving the rider. Docket No. G-008/M-94-1075 dated August 30, 1995. Minnegasco argues that the NAS rider is not properly before the Commission for review at this time. Minnegasco requests that the Judge exclude the testimony of William Glahn from the record of this proceeding. The MPGA sharply disagrees with Minnegasco.

86. Upon consideration of Minnegasco's request, the Judge has determined that the testimony should not be excluded and that it should be weighed and considered in the proceeding. Turning now to Mr. Glahn's testimony, the Judge finds that the testimony has limited probative value. First, it should be noted that a complete record cannot be made considering the changes proposed by Mr. Glahn because there has been inadequate notice to the parties for addressing the merits of the Commission's Order adopting the NAS rider. Therefore, this proceeding is not the appropriate proceeding for addressing these changes. Mr. Glahn himself has also implied that perhaps another proceeding would more appropriately address his proposed changes, particularly because he believes that it would be preferable to have the same New Area Surcharge Rider for all companies so that all new companies would be treated the same. Tr. Vol. 7 at 785, 788.

87. The Judge agrees with the Department that correct application of the New Area Service Charge would remedy the problems identified by the Department and MPGA in this case. In addition, fundamental changes in the tariff should be considered only after some history of its use has been accumulated and in a context that any changes be applied across the board to other companies.

C. Manufactured Gas Plant (MGP Cleanup)

88. Minnegasco has claimed \$6,970,000 in Test Year expenses for environmental cleanup costs. MGC Ex. 26 at 14-15. No party to the proceeding has challenged this expense and it is appropriate that the expense be included in expenses for the Test Year.

89. Minnegasco has received \$272,448 in proceeds of an insurance recovery related to certain environmental costs connected with the manufactured gas plant cleanup incurred in 1991. It is appropriate that all of Minnegasco's 1991 MGP-related insurance recovery proceeds should be applied to the environmental cost tracker as an offset to the MGP expenses to be recovered from Minnegasco's ratepayers.

90. It is inappropriate to apply carrying costs to the tracker balance.

91. The denial of carrying costs decreases Other Rate Base Debits and Credits in rate base by \$1,539,000 and increases the related Accumulated Deferred Income Taxes in rate base by \$627,000. DPS Ex. 85 at 18.

DISCUSSION

No party has taken issue with Minnegasco's \$6,970,000 Test Year expense for environmental cleanup costs. However, there are two contested issues related to Minnegasco's proposed environmental cost tracker for MGP expenses: (1) what amount of MGP-related insurance recovery should be applied to the tracker as an offset to MGP expenses to be recovered from ratepayers; and (2) should carrying costs be applied to the tracker balance.

The Company proposes that insurance recoveries related to 1991 MGP costs should not go into the environmental cost tracker. MGC Ex. 32 at 35-36. The Company argues that because the Company's stockholders and not its ratepayers paid the costs reimbursed by the insurance proceeds at issue, fairness requires that the stockholders be allowed to keep the proceeds. The Department argues that Minnegasco's proposal is inconsistent with Commission precedent on this issue. The Department argues that in a recent Minnegasco case, Docket No. G-008/M-95-292, the Commission opposed offsetting a portion of Minnegasco's current insurance recovery of the Company's 1991 cost by its 1991 non-deferred MGP cleanup costs. The Judge concurs with the Department and finds that Commission policy requires that the MGP-related insurance recoveries be applied to the tracker as an offset to MGP expenses. If the Commission believes that the circumstances in this case are different from the previous docket, it can change its policy.

With respect to the second issue, Minnegasco has proposed that it be allowed to recover carrying costs on the unrecovered portion of the environmental cost tracker account. MGC Ex. 32 at 39. The Department opposes the Company's proposal, asserting that the proposal is inconsistent with Commission precedent. Upon consideration, the Judge concurs with the Department. Minnegasco requested carrying charges on MGP costs in its most recent general rate case and the Commission denied the Company's request. The Commission explained that:

Furthermore, the Commission has generally not allowed carrying charges on deferred manufactured gas plant costs. The Peoples' case cited by the Company is an exception, and the facts in that case were unusual. There, the costs at issue included costs already incurred, which the Commission found should be deferred and examined for prudence and reasonableness in the next rate case. Lengthy deferral of incurred costs is not at issue here.

In the Matter of Minnegasco, Docket No. G-008/GR-93-1090, Order After Reconsideration at 4 (April 4, 1995). The same analysis applies here. A long deferral before recovery is not an issue in this case. DPS Ex. 87 at 10. Moreover, there will be no deferred debit balance to carry forward if the Department's adjustments to MGP costs are accepted by the Commission. DPS Ex. 85 at 14. Therefore, the ALJ adopts the Department's recommendation that carrying costs on the environmental cost tracker account should be denied.

#### D. Compressed Natural Gas Investment

92. Minnegasco initially sought to include in Rate Base its investment in a compressed natural gas refueling station identified as the South Fueling Station. However, the Company has failed to prove that any part of the South Fueling Station is used and useful to ratepayers. Therefore, it is appropriate to exclude the station from Rate Base.

93. The effect of the Department's proposed adjustment is to decrease net General Plant in rate base by \$518,753, increases Accumulated Deferred Income Taxes in rate base by \$170,186, decreases CNG Regulated Margin in the income statement by \$4,753, decreases Sales Expense by \$5,650, and decreases Depreciation Expense by \$27,992. DPS Ex. 85 at 20-21.

### DISCUSSION

Minnegasco proposes to include in rate base a portion of its investment in the South Fueling Station that is used for refueling compressed natural gas vehicles. While the Company initially requested that the entire South Fueling Station investment be included in rate base, its current request is that the percentage of its investment in the South Fueling Station representing the use of the station for fueling utility vehicles be included in rate base.

Minnegasco is also proposing to include in rate base the conversion-kit cost associated with converting new vehicle purchases to alternative fuel vehicles (AFVs). As an alternative fuel provider, Minnegasco is required by the Federal Energy Policy Act to have 30% of its light duty vehicle purchases be AFVs. DPS Ex. 85 at 18. The Department recommends that Minnegasco be allowed to recovery the conversion-kit cost.

With regard to the south station activities, the Department argues that the Commission should deny all Test Year costs of the south station because the fueling station business is a competitive business and should not be included in regulated rates. Minnegasco argues that a percentage of the south side station should be included in the rate base because the fueling station is used and useful and necessary to the efficient use of the fleet. Minnegasco maintains that since the use of AFVs is mandated, it is incumbent on Minnegasco to minimize the cost of using them. The Department responded that Minnegasco's use of the fueling station does not make it a used and useful investment. The Company has other retail suppliers from which it can obtain CNG fuel. DPS Ex. 7 at 12; MGC Ex. 32 at 41.

The Judge agrees with the Department that Minnegasco has failed to prove by a preponderance of the evidence that the refueling station is used or useful or reasonably necessary to its utility service. In addition, Minnegasco has failed to prove that refueling its vehicles at the south side station is more cost effective than fueling at other retail suppliers. It appears that the costs of operating the south station exceeds revenues. DPS Ex. 87 at 13. For a competitive business such as this one, the risk that revenues will not cover costs is properly borne by the Company's shareholders, not its ratepayers.

#### E. Incentive Compensation

94. Minnegasco compensates its employees by giving them a base salary and compensation based on incentives. The Company proposed to include in Test Year Operating Expenses \$1,551,137 for its Incentive Compensation Programs. Minnegasco's



incentive awards are based on achievement of a combination of individual and Company goals. Based upon its investigation, the Department recommends adjustments of the overall incentive compensation amounts in two of Minnegasco's incentive plans: The Officer's Annual Incentive Compensation Plan (the "AICP") and the Officer's Long-Term Incentive Plan (the "LTIP").

95. Under the AICP, the amount earned is based one-half on the achievement of Minnegasco's financial and customer service goals and one-half on achievement of NorAm's consolidated performance measures. The three NorAm performance measures are earnings per share, return on capital employed, and net cash flow from operations. Under the LTIP, the awards are based on a rate of return determined from a composite ranking of other transmission and distribution companies and NorAm's stock price. The Department recommends that 75% of the cost of Minnegasco's AICP and 100% of the cost of the LTIP be disallowed because the programs do not properly balance the interest of customers and investors.

96. The Department's proposed adjustment is reasonable and is hereby adopted by the ALJ.

97. The Department's adjustments will decrease Administrative and General Expense by \$345,301 and increase Other Rate Base Debits and Credits by \$399,398, and decrease Accumulated Deferred Taxes and rate base by \$165,231.

### DISCUSSION

The Department reasons that insofar as the incentive compensation plans' goals align Minnegasco's officers to the interest of shareholders, the costs should not be included in Test Year Operating Expenses. The Judge finds that the Minnegasco and NorAm financial goals directly benefit shareholders. The three NorAm financial goals that are taken into account are earnings per share, earnings on total capital and net cash flow from operations. None of the NorAm financial performance goals align officers to ratepayer interests. NorAm's goals align officers to shareholder interests since they are based on financial performance rather than customer-oriented results. DPS Ex. 85 at 28. The financial and business aspects taken into account in computing Minnegasco's goals are Minnegasco's operating income, earnings on total capital, customer satisfaction index, net cash flow and operating and maintenance per customer. Only two of these performance goals align Minnegasco's executives to ratepayer interests, customer satisfaction and operating and maintenance per customer. However, the remaining Minnegasco goals align officers to shareholder interests, since they are also based on financial performance rather than customer-oriented results. DPS Ex. 85 at 28.

Based on the fact that the Officers' Annual Incentive Compensation plan aligns officer interest with shareholder interests, the Department recommended that the Commission deny 75%, or \$208,540 of the AICP representing the following: all of NorAm's financial goals, which constitutes 50% of the total and approximately half of Minnegasco's goals, which constitutes 25% of the total. DPS Ex. 85 T 28-29.

The performance measures used to determine the Officers' Long-Term Incentive Compensation (LTIP) are based solely on financial performance and not on customer-oriented results. For this reason, the Department recommended that the Commission deny all of Minnegasco's Officers' Long-Term Incentive Compensation since the purpose is to align officers to shareholder interests.

It should be noted that the same officers are eligible for both the Officers' Annual Incentive Compensation and the Officers' Long-Term Incentive Compensation programs. In addition, Minnegasco executive officers may receive AICP incentive compensation up to 48% of base pay. DPS Ex. 85 at 27. The Commission has previously expressed some concern about the percentage of officers' pay coming from incentive compensation.

Another defect in the plan is the large percentage (up to 30% and 40%) of executives' and officers' pay which can come from incentive compensation. These percentages are simply too high. Their stated purpose is to align officers' and executives' interests more closely with those of shareholders. While officers and executives clearly have a duty [of] loyalty to shareholders, they also have a duty to exercise independent judgment on behalf of the Company and to give regulators their full cooperation. Offering key decisionmakers large financial rewards for producing short-term shareholder benefits does not promote regulatory efficiency or the long-term fortunes of the Company. Since the public has an interest in ensuring the long-term viability and stability of the Company, this is a serious defect.

In the Matter of Northern States Power Company, Docket No. G-002/GR-92-1186 at Findings of Fact, Conclusions of Law and Order at 21 (September 1, 1993). The Commission reaffirmed this concern on reconsideration, when it limited NSP's recovery of incentive compensation to 15% of base salary. Id., Order After Reconsideration at 7 (December 30, 1993).

The Judge has considered Minnegasco's arguments on the incentive compensation issue and find the arguments unpersuasive. Minnegasco argues that the incentive compensation plans should be included in Test Year Operating Expenses because the overall level of compensation is reasonable. Minnegasco makes this argument based on the Department's conclusion that the overall level of the Company's total compensation is reasonable and that full rate recovery of this level of compensation would be allowed if the compensation was base pay instead of incentive compensation. DPS Ex. 85 at 22; Tr. Vol. 6 at 626-27. In response to this argument, the Department noted that if the Company's executive compensation was paid as base pay, it would be based on executives' personal performance in their jobs rather than the achievement of financial goals that primarily benefit shareholders. Tr. Vol. 6 at 627.

With respect to Minnegasco's second argument -- that ratepayers' interests are being served by the incentive compensation plans -- Minnegasco has failed to provide any evidence to support this assertion.

Based on the foregoing, the Judge believes that the Department's proposed adjustments are reasonable and should be adopted in this rate proceeding.

F. Coon Rapids Office Building Lease

98. On February 9, 1996, the Department received Minnegasco's letter dated February 5, 1996 to the Administrative Law Judge responding to Mr. Sickmann's rate case hearing questions regarding the Coon Rapids office building lease. Tr. Vol. 3 at 109; Tr. Vol. 4 at 286-87.

99. Minnegasco attached a schedule (MGC Ex. 123) that shows that, contrary to what the Company's witness, Ms. Hagner, stated on page 29 of her direct testimony, the Coon Rapids office building lease revenues are not sufficient to cover all the costs of the property be rented, including the return on rate base. Therefore, the Company proposes to reduce the revenue requirement by approximately \$72,000 to remove the costs and revenues associated with the Coon Rapids office rental.

100. The adjustments to remove the related lease revenue, expense and rate base amounts are appropriate.

G. Exclusion of Minnegasco Exhibits 24 and 27

101. On January 25, 1996 during the hearing in this case, Minnegasco offered into evidence the "Supplemental Direct/Partial Rebuttal" testimony of Daniel O. Hagen (Exhibit 24), and an updated schedule to that testimony made available for the first time on that day (Exhibit 27). These exhibits concern the Low Income Home Energy Assistance Program (LIHEAP). The Department, the OAG and the ECC objected to the inclusion of these exhibits as a part of the record in this proceeding. After hearing substantial argument on the question, the objections were sustained. Minnegasco has renewed its motion to admit the documents.

102. After review of Minnegasco's renewed motion to admit the documents and the arguments submitted by the OAG, the Department and ECC, the Judge concludes that the earlier ruling on this motion is correct and, therefore, continues the exclusion of these documents. The decision was correct for the following reasons:

(a) any reasonably prudent person would view these documents as speculation because they purport to know what the U.S. Congress and the Minnesota State Legislature will do with respect to the LIHEAP issue.

(b) The exhibits were not proper rebuttal testimony because they do not "rebut" the testimony of Ms. Marshall whose testimony deals with rate design issues. Insofar as

the exhibits are claimed to be rebuttal testimony, they violate the spirit and integrity of this expedited hearing process. Insofar as the documents are claimed to be direct testimony, they are improper because they were not filed as a part of the Company's direct case. The Company could have or should have known about the potential for reduction in LIHEAP funding well before the rate case was filed because proposals to cut LIHEAP were made in the spring of 1995, several months before the rate case filing. Also, if the testimony is considered direct, it violates the Prehearing Order because Minnegasco did not request permission to make a rate filing of direct testimony.

(c) It is inappropriate for Minnegasco to amend its rate filing by approximately four and one-half million dollars several months after the case was initially filed with the Commission. Increasing its revenue requirements by four and one-half million dollars is disruptive to the expedited hearing process and in potential violation of Minn. Stat. § 216B.16, subd. 5, which prohibits an increase in rates above the original request filed by the Company.

#### H. The OAG's Proposal for Recovery of Only 75 Percent of Test Year Low-Income Program Costs

103. While Minnegasco and the Department stipulated to the appropriate recovery of the low-income program costs (see Finding No. 72), the OAG proposed that Minnegasco recover only 75 percent of the test year costs of the low-income discount program in rates and that a tracker be used to true-up differences between the amount recovered and net costs of the program, arguing that this would provide Minnegasco with greater incentive to identify savings due to the program. OAG Ex. 94, pp. 18-19.

104. Minnegasco disagreed that the OAG's proposal would provide any further incentive to recognize savings than already exist in Minnegasco's proposal. Under either proposal, a future filing is required in order to identify the net program costs, including savings. Regardless of the recovery level, the same incentive to find savings exists since only the net costs will be recoverable. MGC Ex. 41, pp. 83-84.

105. Since Minnegasco has stipulated to the Department's recommendations on this issue, estimated program savings will be included in the recovery amount. This should accomplish the OAG's goal. DPS Ex. 98, pp. 42-43. The ALJ finds that the OAG's proposal on the low-income program should not be adopted.

#### VII. TEST YEAR RATE BASE

106. Rate base is a measure of the capital supplied by investors to acquire facilities used for delivery of utility services. Northwestern Bell Telephone Company v. State, 253 N.W.2d 815, 818 (Minn. 1977). Minnegasco's investors are entitled to an opportunity to earn a fair rate of return on the property used for delivery of natural gas service in Minnesota.

Minnegasco

Rate Base Summary  
Test Year Ending September 30, 1996 \*  
000's

UTILITY PLANT IN SERVICE

Intangible	\$
51	
Production	
12,353	
Underground Storage	
15,736	
Other Storage	
14,697	
Distribution	
569,279	
General	-
<u>77,656</u>	
Total Utility Plant in Service	\$
689,772	

ACCUMULATED RESERVE

Intangible	\$
30	
Production	
8,800	
Underground Storage	
12,812	
Other Storage	
11,866	
Distribution	
254,588	
General	-
<u>35,452</u>	
Total Accumulated Reserve	\$
323,548	

NET UTILITY PLANT IN SERVICE	\$	366,224
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OTHER RATE BASE ITEMS

Net Acquisition Adjustment	\$	0
Gas Stored Underground - Noncurrent		
997		
Customer Advances		(517)
Accumulated Deferred Income Taxes		
(32,001)		

Working Capital Requirements	
Materials and Supplies	\$
4,759	
Gas Stored Underground - Current	20,778
Liquefied Natural Gas Stored	
1,230	
Liquefied Petroleum (Propane) Gas	
2,831	
Prepayments	
486	
Other Deferred Debits and Credits	(12,410)
Cash from Operating Expenses (lead lag study)	(1,645)
Cash Balances Required	
49	
Cash Available from Tax Collections	_____
493	
TOTAL GAS RATE BASE	\$
351,274	

\* Based on DPS March 21, 1996 corrections

#### VIII. TEST YEAR OPERATING INCOME

107. As a consequence of the Findings of Fact relating to test year operating income, the ALJ finds that the total operating income for the test year is \$26,099,000, as depicted in the following table:

<p style="text-align: center;">Minnegasco Operating Income Summary Test Year Ending September 30, 1996 * 000's</p>	
OPERATING REVENUE	
Sales of Gas	\$
573,060	
Late Payment Charges	
2,554	
Other Revenue	
576	
CNG Regulated Margin	_____
(5)	
TOTAL OPERATING REVENUE	\$ 576,185
OPERATING EXPENSES	
Cost of Gas Purchased	\$
390,511	

Production	
821	
Gas Supply Expense	
578	
Underground Storage	
465	
Other Storage	
642	
Distribution & Utilization	
26,082	
Customer Accounts	
16,924	
Customer Service and Information	9,777
Sales	
2,858	
Administrative and General	30,762
Maintenance	
9,524	
Depreciation and Amortization	—
<u>29,951</u>	
TOTAL OPER., MAIN, DEPRE. EXP.	\$
518,895	
Federal and State Income Taxes	\$
7,379	
Deferred Income Taxes	
589	
Investment Tax Credit Adjustment	(563)
Other Taxes	
23,786	
AFUDC	
<u>0</u>	
TOTAL UTILITY OPERATING INCOME	\$ 26,099

\* Based on DPS March 21, 1996 corrections

## IX. RATE OF RETURN

### A. Capital Structure

108. Capital structure is a financial concept which represents the arrangement of sources of financial capital to a company. The major sources of financial capital are debt and equity. Conceptually, the inquiry is to determine what balance of these capital sources is appropriate for ratemaking purposes; what arrangement is in the best interest of both the utility company and its ratepayers. United Telephone Company, Docket No.

P-430/GR-83-599, Order After Reconsideration (September 6, 1984); Northern States Power Company, Docket No. E-002/GR-87-670 (August 23, 1988).

109. Minnegasco proposed a capital structure consisting of the following components: 49.94% long-term debt, 1.90% short-term debt and 48.16% common equity as its average capitalization during the test year of October 1, 1995 through September 30, 1996.

110. Minnegasco's proposed equity ratio falls within a range of reasonableness for comparable gas distribution companies. Therefore, the proposed capital structure properly balances the interest of ratepayers and shareholders. It is reasonable and appropriate to use Minnegasco's proposed capital structure for determining just and reasonable rates in this proceeding.

111. The appropriate Test Year capital structure for this proceeding is as follows:

<u>Sources of Capital</u>	<u>Percentages</u>
Long-Term Debt	49.94%
Short-Term Debt	1.90%
Common Equity	48.16%

112. Because NorAm faces different business and financial risks, it is appropriate to use Minnegasco's proposed capital structure and not the capital structure of NorAm.

113. It is reasonable to use Minnegasco's stand-alone tax rate to determine tax expense instead of using NorAm's consolidated tax rate.

### DISCUSSION

The reasonableness of a capital structure for regulatory purposes must be based on objective benchmarks such as the average capital structure for a group of companies of comparable risk. Department rate of return witness Dr. Luther Thompson compared Minnegasco's proposed capital structure to the capital structures of the companies in his gas distribution comparable group. He concluded that Minnegasco's equity ratio of 48.16% falls within the middle of the range for the gas-distribution comparable groups in 1994. DPS Ex. 6 at 21-22. Minnegasco's rate of return witness Dr. Bruce Fairchild also compared Minnegasco with other utilities. He examined the capital structure data for the 19 LDCs included in the Value Line Investment Survey for the years 1990-1994 and the American Gas Association composite capital structure ratios for the years 1989-1993. Minnegasco's test year common equity ratio of 48.16 is slightly below the average for the group of 19 LDCs. MGC Ex. 1 at 28-29. Both Dr. Thompson and Dr. Fairchild concluded that the Company's proposed capital structure is reasonable and balances the competing interest of investors and consumers and is similar to comparable companies. DPS Ex. 6 at 22.



In the Company's last rate case, Docket No. G-008/GR-93-1090, the Commission directed that the evidence in this case address the cost of capital and income tax consequences of basing rates on NorAm's capital structure rather than that of Minnegasco. Also, in the Commission's Notice and Order of Hearing initiating this rate proceeding, the Commission required the Company to file additional testimony regarding the consequences of using consolidated tax calculations for the NorAm system instead of statutory tax rates in determining Minnegasco's rates. These issues were addressed in the direct testimony of Dr. Fairchild and Dr. Thompson, also in the testimony of Daniel Higgin and Paul Bjorn, and as well the Department witness Michelle St. Pierre. There is no dispute among these witnesses.

In response to the Commission's directive that the parties examine and recommend whether to use NorAm's or Minnegasco's capital structure in this proceeding, both rate of return witnesses concluded that it was inappropriate to use NorAm's capital structure. Dr. Thompson concluded that using NorAm's capital structure would result in higher revenue requirements due to higher costs for each capital component in NorAm's capital structure reflecting the higher risk associated with NorAm. He testified that Minnegasco's ratepayers should not pay for the higher risk associated with NorAm's actions in areas other than natural gas distribution. DPS Ex. 6 at 24-25. Similarly, Dr. Fairchild testified that Minnegasco's capital structure, rather than NorAm's is appropriate for setting rates because "Minnegasco's cost of capital is consistent with that for a natural gas distribution utility, whereas NorAm's reflects its involvement in gas distribution and, until recently, oil and gas exploration and production activities." MGC Ex. 2 at 2.

Minnegasco witnesses Hagen and Bjorn and Department witness St. Pierre agreed that the use of Minnegasco's stand-alone tax rate to determine tax expense is theoretically proper, is consistent with Commission precedent, and produces a lower revenue requirement than would the use of NorAm's consolidated tax rate. MGC Ex. 4, pp. 5-6, 20; MGC Ex. 23, pp. 2, 6-7, 11; DPS Ex. 85, pp. 32-33.

B. Cost of Long-Term Debt and Short-Term Debt

114. Minnegasco's average cost of long-term debt is 8.7%. The average cost of short-term debt is 6.4%. No party in the proceeding disputes that these are the appropriate costs for long-term debt and short.

C. Cost of Common Equity

1. A Fair Rate of Return

115. The determination of a fair and reasonable return on equity involves a balancing of consumer and utility interests. The Commission must ensure that Minnegasco's authorized rate of return is set at a level which properly balances investor

and consumer interests such that Minnegasco's investors will not earn excess profits at ratepayers' expense.

116. The United States Supreme Court has defined the proper regulatory balance between the interests of investors and ratepayers in two major cases. In Bluefield Waterworks Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), the Court held that a utility's return must be reasonably sufficient to assure financial soundness and provide the utility with the ability to attract capital:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time . . . on investments in other business undertakings which are attended by corresponding risks and uncertainty . . . .

Bluefield, 262 U.S. at 692.

117. In Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), the Court reaffirmed and refined the Bluefield principles. The Hope court reiterated that a utility's return should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital. The Court also stated that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." Hope, 320 U.S. at 603.

118. U. S. Supreme Court decisions have highlighted the significance of establishing a return on equity based on current market conditions. For example, in Bluefield, the Court stated: "A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and businesses generally." See also, United Railways & Elec. Co. v. West, 280 U.S. 234, 239 (1930) ("What is a fair return . . . cannot be settled by invoking decisions of this Court made years ago based on conditions radically different from those which prevail today. The problem is one to be tested primarily by present day conditions.")

119. In addition, the Court has acknowledged that regulation must attempt to strike an equitable balance between investors and ratepayers. In Covington and Lexington Turnpike Road Co. v. Sandford, 164 U.S. 578 (1896), the Supreme Court recognized:

[S]tockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored . . . . The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends.

Covington, 164 U.S. at 596. In Federal Power Commission v. Natural Gas Pipeline Company of America, 315 U.S. 575, 62 S. Ct. 736 (1942), this point was reemphasized:

The consumer interest cannot be disregarded in determining what is a "just and reasonable" rate. Conceivably, a return to the company of the cost of service might not be "just and reasonable" to the public.

Id., S. Ct. at 753 (Black, concurring).

120. In sum, the Commission is obligated to balance the competing interests of Minnegasco's investors and ratepayers in assessing the reasonableness of Minnegasco's proposed rates.

## 2. The Discounted Cash Flow Method

121. The DCF method is a "market-oriented" approach that uses the current dividend yield and the expected growth rate of this yield to determine a required rate of return on a present investment. The cost of equity should be equal to the market-required rate of return. The DCF determined cost of capital is based on market prices and expected returns, which are the best indicators of investors' opportunity costs. Investors base their decisions on the past performance of the company, the company's potential for future growth, the current economic situation, and their opportunity costs. The investors' expectations of the future are based on their assessment of a company's past performance and their expectations about the growth rate of the company's dividends. Therefore, the key components of the DCF method are appropriately the current dividend yield and the expected growth rate for dividends. The sum of these two components equals the estimated cost of equity. DPS Ex. 6 at 15-17.

122. The Minnesota Commission has consistently utilized the DCF technique in making its determinations of rate of return for Minnesota utilities. The Commission has stated: "The DCF method is firmly grounded in modern financial theory, and has been recommended by the Department and the RUD-OAG in this proceeding and by this Commission in nearly every case decided since 1978." Findings of Fact, Conclusions of Law and Order, Interstate Power Co., Docket No. E-001/GR-91-605 (1992) at 34-35.

123. The DCF technique is preferable to other methods of determining the cost of common equity because: (1) it is based on acceptable financial theory; (2) it is based on reasonable assumptions concerning investor's expectations; (3) it is commonly understood and accepted in regulatory proceedings; and (4) it provides the most current rate-of-return estimates when reasonably and consistently applied. DPS Ex. 6 at 15.

124. Dr. Thompson, for the Department, and Dr. Fairchild, for the Company, each conducted a DCF study of a comparable group of gas companies and reached similar results. Dr. Thompson determined that a reasonable range for the comparable group's cost of equity would be 10.9 percent to 11.1 percent with a mean of 11 percent. DPS Ex. 6 at 34. Dr. Fairchild's DCF analysis produced a cost of equity range of 10.6 to 11.6 percent, with a mean of 11.1 percent. MGC Ex. 1 at 63. However, Dr. Fairchild also conducted a risk premium analysis that he combined with the DCF method to derive his range of 11.25 to 12.25. MGC Ex. 6 at 84. From this he determined his recommended return of 12 percent.

### 3. Estimated Cost of Equity for Minnegasco

125. The ALJ adopts the estimated cost of equity determined by Dr. Thompson. He recommends a rate of return on equity of 11 percent for Minnegasco. This recommendation is based upon application of the Discounted Cash Flow (DCF) method to Minnegasco's parent, NorAm, and a risk-comparable gas distribution group. DPS Ex. 6 at 17. A direct DCF analysis on Minnegasco was not done because, as a subsidiary of NorAm, Minnegasco is not a publicly traded company and thus there is no market data available on Minnegasco. Dr. Thompson did conduct a DCF analysis on NorAm, companies comparable to NorAm and companies comparable to Minnegasco. DPS Ex. 6 at 18.

126. Dr. Thompson determined a dividend yield for his comparable group. The dividend yield portion of the DCF formula should be relevant for the current regulatory period. While a spot estimate may capture the investors' expectations on that day, it is only relevant for that day. Looking at longer periods captures current trends for the dividend yield which would be more relevant for setting rates. Therefore, Dr. Thompson looked at yields over 20 trading days, one quarter, one year and two years for a comparable group. DPS Ex. 6 at 18. Dr. Thompson established comparability of his group using several criteria including industry classification, total risk and systematic risk. DPS Ex. 6 at 32; DPS Ex. 7 (LCT-4).

127. Using the most recent quarterly data available from Compustat and the Dow Jones data base, Dr. Thompson established an average dividend yield of 5.577 percent for the comparable group. DPS Ex. 6, Table 6, at 32. Based upon his analysis, he established a recommended range of 5.4 to 5.6 percent. Dr. Thompson used 5.5 percent as a reasonable estimate of the current dividend yield for the current period based upon his professional judgment, taking into account the different yields over the different time periods and the expected trend in the dividend yield. DPS Ex. 6 at 33.

128. Dr. Fairchild criticized Dr. Thompson for allegedly using a current dividend yield instead of the expected dividend yield. He claims Dr. Thompson should have adjusted his recommendation for growth in future dividends. MGC Ex. 2 at 2-4. The criticism has no merit. Dr. Thompson's analysis uses the historical dividend yields to provide a basis for determining growth expectations. Furthermore, the 20-day

dividend yield used in Dr. Thompson's analysis reflects an explicit adjustment for growth in dividends. DPS Ex. 8 at 2, (LCT-6). Contrary to Dr. Fairchild's suggestion, Dr. Thompson's DCF determination is not understated. Dr. Thompson's 5.5 percent current dividend yield incorporates an adjustment for the growth rate and is supported by Value Line's expected dividend yields for Minnegasco's comparable group which is 5.56 percent based on a spot price. DPS Ex. 8 at 3, (LCT-1 at 1).

129. Growth is the rate at which current investors expect dividends to grow through their investment time horizon. Theoretically, the growth rates in dividends per share, earning per share, and book value per share will all grow at the same rate if there is a constant payout ratio, a market-to-book ratio of one and the rate of return on equity is constant. DPS Ex. 6 at 19.

130. As with dividends, the period selected for the growth-rate estimate should be consistent with the current regulatory period and should be based on information available to investors. Dr. Thompson used five and ten-year historical growth rates as well as forecasted rates to determine an estimate of the growth rate. This period is reasonable because growth rates beyond ten years are increasingly less important to current investors and growth rates less than five years are not sufficiently normalized to dampen cyclical highs and lows. Using five and ten-year growth rates appropriately strikes a balance between reflecting current trends, future expectations and long-term stability. DPS Ex. 6 at 21.

131. Dr. Thompson determined growth rates for book value per share, dividend per share and earnings per share for five and ten-year periods for the comparable group. DPS Ex. 6 at 33, Table 7; DPS Ex. 7, LCT-6 at 2-4, 10. Dr. Thompson also looked at the coefficients of variation which measure the stability of the growth rate. DPS Ex. 6 at 34, table 8. He also determined the internal growth rates for the combination group. Id. He determined that the range of growth rates was 4.5 percent to 6.5 percent and that the midpoint of 5.5 percent was the appropriate growth rate.

132. The estimated cost of equity is the sum of the dividend yield and the growth component. Adding the 5.50 percent current dividend yield to the 5.5 percent growth rate results in a cost of equity for the gas distribution group of 11 percent. DPS Ex. 6 at 34. A return on equity of 11 percent is consistent with the generally accepted risk/rate of return guidelines, will allow Minnegasco to attract capital and maintain its financial integrity. DPS Ex. 6 at 42.

133. Dr. Fairchild's assertion that Dr. Thompson's growth rates are understated is without merit. MGC Ex. 2 at 8-9. Dr. Thompson's range of growth rates is based on historical and forecasted growth rates, excludes both the highest and lowest growth rates and is significantly higher than the average of all estimated growth rates for Minnegasco's comparable group. DPS Ex. 8 at 4; DPS Ex. 6, Table 7 at 33.

134. Dr. Fairchild asserted that a flotation cost adjustment of 22 basis points should be added to Dr. Thompson's recommendation to cover the costs associated with issuing new securities. MGC Ex. 2 at 13.

135. Dr. Thompson believed that there was no reason for such an adjustment because NorAm has no plans to issue significant amounts of new stock for Minnegasco's capital. DPS Ex. 6 at 31. There is no reason for current Minnegasco investors to expect a flotation allowance for Minnegasco and no evidence that NorAm incurred any flotation costs when it acquired Minnegasco. Therefore, such an allowance would be a windfall for NorAm and an unjustified burden on ratepayers. DPS Ex. 8 at 6. Minnegasco has not demonstrated that it or NorAm incurred any flotation costs or will do so in the test year. Therefore, no flotation cost adjustment should be made in this case.

136. Minnegasco witness Dr. Fairchild based his recommendation on the results of two analyses: 1) application of the DCF model to a group of 19 other LDCs; and 2) application of the risk premium method to the same group of LDCs. As stated above, Dr. Fairchild's DCF analysis resulted in a cost of equity range for Minnegasco of 10.6 percent to 11.6 percent. MGC Ex. 1 at 6. His risk premium analysis resulted in a cost of equity range of 11.8 to 12.7 percent. Dr. Fairchild believed that "Taken together, these analyses implied that the cost of equity for Minnegasco is in the range of 11.25 to 12.25 percent." MGC Ex. 1 at 7. He selected a return of 12 percent, which is above the midpoint of this range. *Id.* In his rebuttal testimony, he suggested a series of adjustments to Dr. Thompson's proposal to derive a cost of equity of 11.50 percent. MGC Ex. 2 at 13.

137. Dr. Fairchild's DCF analysis is flawed because his application of the DCF model relies on limited price information from Value Line, which produces unreliable estimates for regulatory purposes. Dr. Fairchild made no effort to normalize the Value Line group based on recognized risk measures, despite the acknowledged variability in the growth rates for the companies in his group. DPS Ex. 6 at 45.

138. Dr. Fairchild also relied on a risk premium analysis. In the risk premium method, the cost of equity is estimated by determining the additional return investors require to forego the relatively less risk bonds for the greater risks associated with common stock and then adding this equity risk premium to the current yield on bonds. Dr. Fairchild used studies of equity risk premiums for utilities reported in the academic and trade literature as a basis for estimating the cost of equity using the same group of 19 LDCs as a proxy for Minnegasco. MGC Ex. 1 at 63.

139. Dr. Fairchild's risk-premium analyses does not support his DCF analysis. Dr. Thompson indicated that Dr. Fairchild's risk-premium analysis "does not produce a better rate-of-return estimate for regulatory purposes because of the difficulty in determining appropriate expected risk premiums. Current dividend yields and expected growth rates can be determined without the difficulties of risk-premium methods." DPS Ex. 5 at 44, 45.

140. The risk-premium analysis of Dr. Fairchild is based on an inconsistent mix of time periods for determining a current cost of equity based on risk premiums. Furthermore, Dr. Fairchild's CAPM risk premium analysis is fraught with the difficulty of determining an appropriate Beta, a return on riskless assets, and a required market rate of return. The studies relied on by Dr. Fairchild were conducted twenty years ago on electric utilities and thus do not address current risk premiums for gas distribution companies. DPS Ex. 6 at 45, 46.

141. The ALJ finds that Dr. Fairchild's "DCF plus risk premium" analysis should be rejected and Dr. Thompson's "DCF only" method should be used in this case. Id. at 46. For all of the reasons discussed above, the ALJ concludes that the estimated cost of equity for Minnegasco should be 11 percent.

#### D. Overall Rate of Return

142. The overall rate of return is calculated by multiplying the capitalization ratios by their appropriate costs. The sum of these weighted costs is the overall rate of return on capital. The overall rate of return in this proceeding is found to be 9.76 percent, based on the following calculation:

	<u>Capital Structure</u>	<u>Cost of Capital</u>	<u>Weighted Cost</u>
Long-Term Debt	49.94%	8.70%	4.34
Short-Term Debt	1.90%	6.40%	.12
Common Equity	<u>48.16%</u>	<u>11.00%</u>	<u>5.30</u>
	100.00%		9.76

#### X. REVENUE DEFICIENCY COMPUTATION

143. As a consequence of the Findings of Fact regarding Rate Base, Test Year Operating Income, and Overall Rate of Return, the revenue deficiency for Minnegasco is \$13,960,000, as hereinafter calculated:

#### Minnegasco Revenue Requirements Summary Test Year Ending September 30, 1996 \* 000's

Average Rate Base	\$
351,274	
Rate of Return	
9.76%	

Required Operating Income	
34,284	
Operating Income	
26,099	
Income Deficiency	\$
8,185	
Gross Revenue Conversion Factor	
1.7056	
Gross Revenue Deficiency	\$
13,960	

\* Based upon DPS March 21, 1996 corrections.

## XI. CONCEPTS TO GOVERN

144. It is the intention of the Administrative Law Judge that the concepts set forth in the Findings herein should govern the mathematical and computational aspects of the Findings. Any mathematical or computational errors are unintentional and should be corrected to conform to the concepts expressed in the Findings.

## XII. RATE DESIGN

### A. Rate Design Overview

145. After a utility's revenue requirement is determined, the Commission must evaluate the rates the utility proposes to charge its classes of customers for the purpose of establishing an appropriate rate design. Rate design is the process of setting rates which will recover the utility's revenue requirement in a manner that is fair to the utility and to its customers. In general, rates should be designed to meet the following goals:

1. To provide the company a reasonable opportunity to recover all prudently incurred costs, including costs of attracting capital;
2. To promote efficient use of society's resources;
3. To provide a reasonable continuity with historical rates and conditions of service; and
4. To be easy to understand and administer.

DPS Ex. 97 at 2.

146. Overall, these criteria help ensure that Minnegasco will provide service at reasonable and understandable rates. In addition, these criteria help ensure that changes in rates and conditions of service are sufficiently gradual to avoid effects of drastic rate change on customers. Id. at 2.



147. Minnegasco has the burden of proving that the rate design it proposes is just and reasonable and not unreasonably prejudicial, preferential or discriminatory. Minn. Stat. §§ 216B.03 and 216B.16, subd. 4. If Minnegasco does not establish the reasonableness of its proposed rate design, then the Commission must determine a just and reasonable rate design. Minn. Stat. § 216B.16, subd. 5.

148. When designing rates, the Commission acts in its quasi-legislative capacity to apportion the revenue responsibility among Minnegasco's different customers. The Commission balances several important cost and non-cost factors in carrying out this responsibility and makes "choices among public policy alternatives." Hibbing Taconite Co. v. Minnesota Public Service Commission, 302 N.W.2d 5, 9 (Minn. 1981). In recognition of this quasi-legislative process, the courts have shown substantial deference to the Commission's rate design decisions. This deference results from a judicial awareness that the Commission must apply its discretion and expertise in designing rates. Id.; St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission, 251 N.W.2d 350 (Minn. 1977).

149. Minnesota courts have never articulated the specific factors to be considered in designing rates. However, in Reserve Mining Company v. Minnesota Public Utilities Commission, 334 N.W.2d 389 (Minn. 1983), the court specifically rejected a claim that cost of service represented the paramount factor for consideration in setting rates, stating:

The appellant's argument that the cost of providing service should be the single most important consideration in the setting of utility rates undervalues the PUC's obligation to also review and balance non-cost factors when determining revenue responsibilities for different classes of customers. This court has recognized that rate levels for a class must ultimately be the product of many countervailing considerations, including non-cost factors, as well as the results of cost studies.

Id. at 393 (emphasis added).

150. The Minnesota Supreme Court has discussed several relevant non-cost factors, including: the impact a rate design would have on different customers; the customer's ability to pay; the ability to pass on the increased cost of energy to others; and the ability of businesses to realize part of an energy cost increase as an income tax savings. Reserve Mining Company v. Minnesota Public Utilities Commission, 334 N.W.2d 389 (Minn. 1983). Specifically, with respect to the impact of a particular rate design on customers, the court stated:

One consideration applied by the PUC in its rate determination was the impact a rate change would have on different customers. This factor is appropriate because a precipitous increase in one class's

rate when rates charged to other classes are declining, or a decrease in one class's rate when overall costs or marginal costs are increasing, may be unreasonable even though that class is already above the cost of service attributed to it by the appropriate cost of service study.

Reserve Mining Company v. Minnesota Public Utilities Commission at 393.

## DISCUSSION

According to the caselaw summarized above, the Commission has substantial discretion to exercise its quasi-legislative authority to design rates taking into consideration a multiplicity of factors. Cost is one of those factors. The Commission must determine based on this record which rate design goals are appropriate for this case. The Judge has considered this question and finds that the rate design goals identified by the Department are appropriate for this case.

### B. Public Comments Regarding the Rate Increase

151. The Judge received a number of comments from ratepayers, interested persons, and organizations both at the public hearings and in posthearing submissions. Sixty-one letters and a number telephone contact summaries from the Commission's consumer complaint staff were submitted. Almost all of the comments opposed increases in the basic charge or gas rate. The comments are summarized in the following Findings.

152. The Judge notes that the public hearings were poorly attended except for the attendance of the Minnesota Utility Investors who probably comprised 95% of the people in attendance. At the Mankato hearing they were 100 % of the persons in attendance.

153. Members of Minnesota Utility Investors (MUI) spoke at the public hearings in this matter. MUI is an organization comprised of shareholders of public utilities, including Minnegasco. The following concerns were expressed by MUI members:

- (a) The typical utility investor is over the age of sixty and retired. Such an investor owns relatively few shares of stock, earns a low to moderate income, and uses dividend income to supplement pension and Social Security benefits.
- (b) Because of the typical utility investor's financial situation, such an investor cannot take substantial risk in investments. A fair and consistent return on investment and stable valuation of assets are required to meet the financial needs of these investors.

- (c) Statewide and nationally, changes are occurring in the regulatory process that could affect both dividend income and asset valuation. One example is the Federal Energy Regulatory Commission (FERC) reallocation of risk from pipelines to utilities. Other potential changes are unbundled services, deregulated services, deregulated markets, market-based pricing, incentive ratemaking, regulatory compact alterations, and modifications of a utility's obligation to serve. The utility industry is becoming market-oriented, more competitive, and a greater risk for investors.
- (d) Local distribution companies (LDCs) will face fiscal distress where pricing is not flexible and successful performance does not result in recognized profits.
- (e) If the utility industry is financially weakened, utility companies will be unable to attract capital, putting continued natural gas service at risk.

To avert the problems perceived by MUI, the group suggests that Minnegasco be awarded a return on equity (ROE) of 11.82 percent. The MUI calculation includes an ROE average of 11.52 for twenty other utilities nationally. The group suggests a flotation adjustment of .15 to compensate the utility for the cost incurred in the equity offering. MUI maintains that the ROE of 11.82 would meet the standard of adequate return on investment set out in Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923). The suggested ROE figure would also, in MUI's opinion, afford fair treatment for all interested persons in mandated environmental clean-up expenses, partial recovery of the Midwest Gas acquisition adjustment, participation in the low-income pilot project, and reducing subsidies across rate classes.

154. Several non-MUI commentators indicated that the time of year, being within the heating season, is problematic for raising the rates on homeowners and customers with fixed incomes.

155. A commentator questioned whether the proposed rate increases were being used to subsidize Minnegasco's office space at LaSalle Court. The commentator suggested that the space was an improper luxury for a public utility to include in its rate base.

156. Many residential customers strongly objected to the rate increase on basic charges. They pointed out that the increase from \$5.00 to \$6.75 amounted to a thirty-five percent increase. One commentator suggested using variable rates to recover the costs involved. Two commentators suggested that through wise use of technology, administrative costs could be lowered. Quarterly billing was suggested by another commentator as a means of reducing costs. One commentator suggested that the basic charge of \$4.00, last charged in May, 1995, was the proper charge for calculation

of the increase in the charge amount. By that calculation, the proposal is a 68.75 percent increase.

157. The relationship between the low-income pilot project and the Heatshare program with the Salvation Army was questioned by one commentator. The commentator wondered whether the pilot project is supplanting the Heatshare program. Several commentators questioned why ratepayers were subsidizing persons who could not pay for service. One commentator suggested that Minnegasco pay for the low-income pilot project. Another objected to Minnegasco deciding what social services are to be provided with ratepayers' money.

158. A number of commentators objected to the residential customer increase in natural gas prices of 7.7 percent. The commentators pointed out that small business customers would experience an increase of either 7.7 or 4.2 percent. All other business customers would experience a rate decrease. The commentators objected to the difference in rate changes as fundamentally unfair. A commentator questioned whether the utility's goal was to charge all classes of customer at the same rate of return. Several customers compared the rate of proposed increase to the 2.6 percent cost of living increase received in Social Security benefits. One commentator suggested holding the rate increase to the inflation rate.

159. One commentator noted that there are proposals for increasing Medicare premiums by another \$11.00 per month, resulting in financial hardship for retired persons. Other commentators indicated that they cut back on home heating to make ends meet, enduring substantial hardships. One commentator suggested the utility was raising homeowner rates because that group of customers has less influence than large business customers.

160. The impact of increasing utility rates on residential customers with fixed incomes was raised as a reason to not increase residential rates. Many commentators suggested that consideration be given to persons with fixed incomes who do not qualify for the low-income pilot project. Another commentator suggested allowing no increase greater than the rate of inflation.

161. One commentator questioned what customers received the 3.1 percent interim rate increase and how the interim rate increase relates to the overall rate increase sought. Another commentator questioned whether Minnegasco would be seeking a rate increase next year.

162. A commentator wrote indicating that for thousands of Minnesotans, the rates charged for natural gas are already too high. The commentator indicated that many people were seeking alternative heating methods. Persons in older homes, like the writer, experience high energy costs, even with added insulation. Another commentator indicated that mobile homes had limits to the degree weatherization would conserve heat and cut energy costs. The costs of conservation programs was criticized as unnecessary by another commentator. That person suggested that anyone of average intelligence can determine what changes can be made to conserve energy.

163. A comparison of natural gas prices in Texas to the price in Minnesota was submitted by one commentator. The prices in Texas ranged from \$1.35 to \$1.65 per cubic foot. The price in Minnesota was asserted to be \$4.21 per cubic foot. The commentator asserted that the costs of transportation were minimal and questioned why the amounts charged per cubic foot differed so widely between Texas and Minnesota.

164. A substantial number of commentators suggested any increase was too high for fixed income customers and that Minnegasco should cut costs rather than raise rates. Several commentators suggested having customers send in meter readings, rather than sending an employee to read meters as a cost saving measure. One commentator questioned the number of vice-presidents at Minnegasco and suggested that executive salaries and bonuses be reduced. Another commentator suggested using CEO salary and shareholder dividends to cover any increased costs experienced by Minnegasco.

165. A commentator related the problems he had in obtaining information from Minnegasco. Upon calling the company, the commentator was told that the answer could only be obtained from a field person and all of them were out. The commentator indicated that there should be no rate increase in light of that level of service.

166. One commentator disputed assertions that competition exists in the utility industry. The commentator suggested a lesser rate of increase. The highest rate increase suggested was 1.5 percent, and the commentator opined that were the underlying facts known, even that rate increase would be considered ridiculous. Another commentator suggested that the fair way of adjusting rates was a 1.5 percent increase across all classifications of ratepayers. Another commentator urged that fair and equitable rates be set for all categories of customers and proposed a rate increase of 4.2 percent or less for all customers.

167. One "concerned residential customer" questioned whether Minnegasco's residential rate increase was an incentive for large scale business consumers to use more natural gas, regardless of conservation. The commentator viewed the 7.7 percent rate increase as punishing residential consumer for not using enough natural gas. The rate changes were characterized as residential consumers subsidizing business consumers.

168. An analysis of base rates per therm was done by one commentator who concluded that the "rates seem excessive, especially on a percentage basis." The commentator criticized the proposed rates as not being in the best interest of the public and not consistent with good business practices.

169. The disparity between business and residential customer rates was criticized by one commentator as benefiting business consumers disproportionately. The commentator asserted that Minnegasco has not presented sufficient information to support the different treatment of residential and commercial consumers. To determine the propriety of any rate increase, the commentator suggested a "benchmark" of

operator efficiency to ensure Minnegasco is not being rewarded for poor business practices.

170. The response time of Minnegasco's Service Plus repair operation was questioned by one commentator. That person suggested that, if a rate increase is approved, more staff be available to handle customer furnace problems.

171. A number of commentators suggested that a rate increase was unfair, because Minnegasco had a rate increase "not long ago."

172. The existence of rate regulation was criticized by one commentator, who suggested that rate increases were necessary due to government mandates and a lack of free enterprise.

173. Two commentators pointed out that they changed from propane to natural gas based on Minnegasco's representations regarding price. The commentators believe that an increase in rates is unfair, since Minnegasco was not advertising the anticipated rate increase.

#### C. Minnegasco's Class Cost of Service Studies

174. Minnegasco filed a separate Class Cost of Service Study ("CCOSS") for both the Minnegasco - Northern and the Minnegasco - Viking rate areas. MGC Ex. 37, schd. 9 and 10. The CCOSSs are fully-distributed, embedded class studies which were prepared using a standard three-step approach which allocated costs to each rate class based on the degree to which the costs were caused by that class. MGC Ex. 37, pp. 36-37.

175. Minnegasco's CCOSSs were prepared in a manner similar to the studies that were approved by the Commission in Minnegasco's last two rate cases (Docket Nos. G-008/GR-92-400 and G-008/GR-93-1090). MGC Ex. 37, pp. 46-50; DPS Ex. 81, p. 5.

176. The Department recommended that the Commission accept Minnegasco's CCOSSs and relied on them in developing its rate design and revenue apportionment recommendations. DPS Ex. 81, p. 8; Tr. Vol. 5, p. 568.

177. The OAG discussed marginal cost studies as compared to fully distributed or embedded cost studies, but did not prepare any marginal cost study in this case. Tr. Vol. 5, p. 568.

178. The Administrative Law Judge finds that Minnegasco's Class Cost of Service Studies reasonably comply with recent Commission precedent and provide an evidentiary basis for assigning customer class costs of service.

#### DISCUSSION

In order to assign class cost of service a class cost of service study must be a part of this record. Minnegasco's Class Cost of Service Study provides the Company a basis for asserting that particular classes have imposed a certain cost on the system. The Department has recommended that the Company's CCOSs be used for assigning class costs in this proceeding. Only the OAG and the SRA have expressed opposition to the Company's CCOSs.

Minnegasco uses a minimum system study to classify the cost of natural gas distribution mains in developing its CCOSs. A minimum system approach assumes that a certain investment will be required to develop a hypothetical distribution system of a minimum size sufficient to make service available to all existing customers. The SRA argued that Minnegasco's use of a minimum system study for classifying costs of gas distribution mains was improper and resulted in over-stated costs for residential customers in the CCOSs. SRA Exhibit 89 at 4. The SRA recommends an alternative customer allocation for distribution mains known as "zero intercept" analysis which hypothesizes mains with virtually no capacity. Tr. Vol. 4 at 13.

Minnegasco responded stating that it had used the minimum system approach to allocate distribution mains in its two prior rate cases, and the approach was accepted by the Commission in both cases. In addition the Commission has approved of the use of this system for Peoples Natural Gas, and has required NSP to provide a study of this type in its next rate case. MGC Exhibit 41 at 89 - 90. The Company argued that the minimum system approach is used by the vast majority of gas utilities and is recognized as standard practice by the American Gas Association. For this reason Minnegasco asserts that the SRA's preferred zero intercept approach is unreasonable since it is based on a system with no ability to serve customers. In addition the Company identifies that the approach itself is not detailed in the record. The ALJ finds that the use of the minimum system approach has been previously recognized by the Commission and is reasonable for use in this proceeding.

The SRA also criticized Minnegasco's inclusion of environmental cleanup costs in the customer cost portion of the CCOSs, stating that the manufactured gas plant costs were not treated as customer costs at the time the plants were in service. SRA Initial Brief, pp. 11, 26. Minnegasco responded arguing that there is no evidence in the record that environmental costs were not treated as customer costs when the plants were in service and questioning the relevance of this issue at this point in time of how the plants may have been treated decades ago when the plants were operating.

The Judge is unpersuaded by SRA's claims regarding inclusion of environmental cleanup costs and finds that Minnegasco's treatment of the environmental costs in the CCOSs is appropriate.

The OAG argued that fully distributed or embedded cost studies are inadequate for determining cost of service for classes of customers. The OAG recommended the use of marginal cost studies for determining the cost of service for customer classes. The OAG did not prepare a marginal cost study in this case.

The purpose of a class cost of service study is to provide an evidentiary basis for assigning costs to customer classes equal to the revenue required by the utility to provide reliable, efficient and economical service. Without a class cost of service study, the utility would have no basis for assigning class costs. Therefore, a class cost of service study is a method for making generalized conclusions based on judgment about the assignment of cost to customer classes. This is what Minnegasco's class cost of service studies are intended to do, they provide an evidentiary basis for assigning class revenue responsibility. This is all that Minnegasco's class cost of studies do and nothing more. The Judge has concluded that Minnegasco's CCOSSs are adequate for this purpose. It is important to note that Minnegasco's CCOSSs do not pretend or even begin to address economic efficiency issues. Problems with an embedded cost of service study occur when a party claims that such a study "sends price signals", or "identifies subsidies": these are economic efficiency issues. The OAG argues persuasively, with substantial scholarly authority, that on economic efficiency issues (i.e., "sending price signals" or "competition"), marginal cost studies are necessary. The Judge rejects any claim by Minnegasco that its CCOSSs which are based on embedded costs address economic efficiency issues.

The ALJ finds that Minnegasco's CCOSSs are reasonable and appropriate for making generalized conclusions about class cost of service.

D. Revenue Apportionment by Customer Class

179. In its initial filing, Minnegasco proposed an overall increase in revenue requirements of \$24,302,851 representing a 4.2% increase. Minnegasco, the Department and the OAG have proposed different rate designs for collection of the revenue requirement from Minnegasco's customer classes.

180. Minnegasco proposes the following revenue apportionment:

	<u>Northern Area</u>	<u>Viking Area</u>
1. Residential and Commercial A:	+ 7.7%	+ 7.7%
2. Commercial B:	+ 4.2%	6.9%
3. Commercial C:	(2.1%)	0.0%
4. Small Dual Fuel A:	(1.7%)	0.0%
5. Small Dual Fuel B:	(3.9%)	0.0%
6. Large General Service:	0.0%	N/A
7. Large Dual Fuel A:	(1.5%)	N/A
8. Large Dual Fuel B:	(7.7%)	N/A

181. The Department proposes the following revenue apportionment among Minnegasco's customer classes:

<u>Northern Area</u>	<u>Viking Area</u>
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1. Residential	+ 6.29%	+6.81%
2. Commercial	+ 1.05%	+3.60%
3. Large General Service	+ .04%	N/A
4. Small Dual-Fuel	+ .34%	N/A
5. Large Dual-Fuel Sales & Trans.	+ 3.02%	N/A

182. The OAG proposes that the Commission continue the revenue apportionment placed in effect for Minnegasco during the Company's last rate case proceeding. The OAG reasons that because Minnegasco has failed to show that the current revenue apportionment is unreasonable that revenue apportionment should be continued in this case.

183. The Department's proposed revenue reapportionment for the customer classes moves customer classes towards actual costs at a more reasonable pace than that proposed by Minnegasco and reduces rate shock and increases customer acceptance. The proposal meets rate design goals, is reasonable, and should be adopted in this case.

### DISCUSSION

Minnegasco proposes that its small firm customers bear all the proposed increase while the rate for other classes are either maintained or actually decreased. DPS Ex. 98 at 11. The Department argues that the increase proposed for residential and small business customers is too large to be fair or reasonable given that other customer classes will experience an actual decrease or no change. The Department further asserted that the Company's decision to assign all increased revenue responsibility to the classes with the least ability to exercise the options created by competition is particularly unfair. The Department explained that the Company's proposal would result in residential customers experiencing their third, and largest, rate increase in three years. The Department concluded that the abrupt changes proposed by Minnegasco would place an excessive burden on Minnegasco's small customers.

In addition, the Judge notes that numerous Minnegasco customers have expressed concern about the effects of the proposed increase on residential and senior citizen customers. Many have expressed concern about the fairness of the proposed increase recognizing that residential and small business customers are the only rate classes that will receive an increase in rates. Based on the comments in correspondence received by the Judge, the Judge finds that there is a lack of customer acceptance of the revenue apportionment among classes proposed by Minnegasco.

While the Department also recommended moving the revenue apportionment to customer classes closer to the costs imposed by the class, it concluded that the changes proposed by Minnegasco were too drastic. The Department's recommendations move price towards cost at a more reasonable pace than that proposed by Minnegasco. The Department's recommendations are based on the recognition that cost is only one factor in

arriving at just and reasonable rates. The structure proposed by the Department more thoroughly apportions revenue responsibilities so as to balance more appropriately the goals of continuity and customer acceptance with cost-price alignment. Finally the Department's recommendations also temper the proposed increases for the larger customers to keep their rates competitive. For all these reasons, the Judge recommends that the Commission adopt the class revenue apportionment proposed by the Department.

The SRA recommended that residential class percentage increase in this proceeding be limited to no more than 150% of the overall increase. This recommendation was based on the SRA's claim that Minnegasco's classification of costs as "customer-related" overstated the costs allocated to the residential class. SRA Ex. 89 at 20. The Judge has previously determined that Minnegasco's determination of customer costs are reasonably consistent with Commission precedent and SRA's preferred use of a "zero intercept" analysis and its position on minimum main systems have been rejected. Because these serve as a basis for its proposed classification of costs, SRA's proposal must be rejected.

E. Particular Rate Design Issues

1. Minnegasco's Modified Proposed Basic (Customer) Charges

184. Minnegasco proposed changes to the basic charge to more closely align the basic charge with the fixed cost of serving the respective customer classes. MGC Ex. 37, pp. 64-66.

185. The Department proposed a smaller residential basic charge, changes to some of the commercial and industrial classes, higher basic charges for small volume dual fuel customers and disagreed with Minnegasco's proposed elimination of the \$100 differential between transportation and service customers. DPS Ex. 98, pp. 13-18.

186. Minnegasco agreed with the Department's recommendations regarding one of the commercial and industrial classes and the small volume dual fuels class' basic charge. MGC Ex. 41, pp. 64-65. The ALJ finds that the basic charges for those classes on which Minnegasco and the Department agree should be adopted.

2. Increase to the Residential Basic Charge

187. Minnegasco proposes to increase the residential basic charge from \$5.00 per month to \$6.75 per month on the basis that the Company's CCOSs showed that Minnegasco is currently receiving less than 33% and 42% of customer-related costs through the basic charge for the Northern area and Viking area customers, respectively. MGC Ex. 37 at 66. The Department agreed that the basic charge should be increased but that the increase should be more measured and no more than the basic customer charge of other comparable Minnesota regulated gas companies.

188. The ALJ finds that the Department's proposed increase in basic charge from \$5.00 to \$6.00 per month is reasonable and appropriate and should be adopted.

### DISCUSSION

Minnegasco proposed to increase the monthly residential customer charge from its current rate of \$5.00 per bill to \$6.75 per bill. It argued that such a substantial increase is needed for two reasons. First, the Company indicated that it is recovering less than half of its identified customer-related costs through the basic customer charge. MGC Ex. 37 at 66. Second, the difference between the customer charge and cost is recovered through the delivery charge. Because the delivery charge is based on the amount of gas used and fixed-cost recovery is based on average use, recovering customer-related costs through the delivery charge results in higher-use customers subsidizing lower-use customers within the class. Id. at 67.

Acknowledging that the customer charge does not recover the Company's customer costs, the Department recommended an increase from \$5.00 to \$6.00 per monthly bill, which would make Minnegasco's customer charge consistent with the residential customer charge approved by the Commission for Northern States Power Company and Peoples Natural Gas Company. There is no dispute that the residential customer charge does not recover cost and that setting customer charges closer to cost makes revenue recovery fairer within the customer class. DPS Ex. 98 at 14.

The Company opposed the Department proposal and argued that there is no meaningful difference to customers whether the customer charge is \$6.00 or \$6.75. However, the Department observed that Minnegasco's proposed increase of \$1.75 per bill is nearly twice that proposed by the Department.

The ALJ finds that the Department's proposed increase to \$6.00 represents a reasonable increase that is more appropriate to a measured transition to more cost-based charges. The Department's proposal also aligns Minnegasco with comparable gas companies in their customer charge.

The SRA recommended that the residential basic charge not be raised at all, based on the disagreements with Minnegasco's classifications in the CCOSs. SRA Ex. 89, pp. 18-19. The Judge has already considered and rejected SRA's disagreements with Minnegasco's cost classification system. The SRA also stated that the residential basic charge should not be increased because Minnegasco's customer education effort regarding the basic charge was inadequate. Minnegasco responded by stating that it has undertaken a communication effort to educate its customers on this topic. MGC Ex. 41, p. 93.

3. Increase in the Basic Charge for Commercial & Industrial ("C & I") "A" Customers

189. Minnegasco proposed to increase the basic charge for C & I "A" customers in the Northern area from \$9.00 to \$11.00 per month and in the Viking area from \$6.00 to \$7.00 per month. MGC Ex. 37, p. 72.

190. The Department agreed with Minnegasco regarding the Viking increase, but they recommended an increase to only \$10.00 for the Northern area. DPS Ex. 98, p. 16.

191. Minnegasco's CCROSS shows that the average cost of serving C & I "A" customers in the Northern area is approximately \$23.00, therefore, Minnegasco's recommended basic charge is still less than 50% of the fixed costs, and further reduces the intra-class subsidy in the customer class. MGC Ex. 37, p. 74. The ALJ finds that Minnegasco's proposed increases are reasonable and appropriate.

4. Elimination of the \$100 Differential Between Transportation and Sales

192. Minnegasco proposes to eliminate the \$100 differential in basic charge between transportation and sales service customers in the Large Volume Dual Fuel class. Because the Company has failed to provide any documentary support for this proposed change, the ALJ finds that the Company's proposal to eliminate the differences between large volume sales and transportation customers should be denied.

DISCUSSION

Minnegasco proposed to set the basic customer charges for its large volume sales and for its transportation customers at the same level. Minnegasco currently recovers \$1,200 more per year from each transportation customer than from each sales customer. This rate difference exists due to Minnegasco's assertion in its last rate case that the \$100.00 monthly premium for large-volume transportation service was "necessary to properly reflect the higher customer-related costs associated with Transportation Service." DPS Ex. 98, Schedule CO-4. The Company now argues that eliminating the difference between sales and transportation services is needed to maintain consistency and preserve Minnegasco's financial indifference regarding whether customers chose sales service or transportation service. Id. The Company now asserts that the same level of charges for these services is appropriate because the same level of costs is incurred to manage the accounts whether they receive sales service or transportation service.

The Department recommended that the Company's proposal to eliminate differences between the basic customer charge for the Large Volume Sales and Transportation Service be denied because Minnegasco's arguments are without support in the record. In response to a Department information request, the Company stated that "the CCROSS does not make a distinction between the system/sales classes and the transportation classes." DPS Ex. 98, Schedule CO-3; i.e., there is no cost basis to support the reasonableness of the change sought by the Company. In its rebuttal testimony, the Company stated: "Minnegasco does not believe it is appropriate at this

time, or particularly helpful, to identify the separate cost of service, including customer costs, for transportation and sales service through its Class Cost of Service Study." MGC Ex. 40 at 66. Finally during the hearing, Minnegasco witness Adam Pyles admitted that he could not identify any numbers in the record that would show that the requested change was supported by data regarding costs. Tr., Vol. IV at 304. Under Minn. Stat. § 216B. 16, subd. 4 (1994), the public utility seeking a change in rates has the burden of showing that the proposed change is just and reasonable. The Company has failed to meet this burden and its request must be denied.

#### 5. The Department's Recommendation to Adopt Seasonal Rates

193. The Department recommended adoption of seasonality in the margin of all firm sales and transportation rates, which would amount to increasing the non-gas margin by \$0.05 per dekatherm for peak gas use, with a corresponding decrease for non-peak gas use. DPS Ex. 98, pp. 25-26.

194. Minnegasco recommended that this system not be adopted since seasonality already exists through the fluctuation of the commodity cost of gas through the year, the increased volume of gas consumed through the winter months means customers' bills are already higher in the winter, and the Department's proposal is unlikely to have any real effect on customer consumption. MGC Ex. 41, pp. 68, 70; schd. 20; Tr. Vol. 5, pp. 575-577, 581-582.

195. The Commission thoroughly reviewed the issue of seasonal rates in NSP's 1992 gas utility rate case. The Commission rejected a similar proposal by the Department in that matter for the same reasons given by Minnegasco and stated that several issues needed to be studied further in this area. MGC Ex. 100, pp. 67-68.

196. The issues cited by the Commission that needed to be explored have not been explored in this proceeding, so the reasons the Commission gave for rejecting the seasonal rates in NSP's case apply to the current situation. Tr. Vol. 5, pp. 577-580. Therefore, the ALJ finds that the Department's proposal to adopt seasonal rates is not reasonable.

#### 6. Marginal Class Cost of Service Study

197. The Department recommended that Minnegasco file in its next rate case a class cost of service study based on marginal cost instead of embedded cost. Upon consideration of this proposal, the Judge finds that because of the potential that rates are moving closer to their embedded costs and because of the increasing trend toward discussions regarding "subsidies", "price signals" and competition, Minnegasco should file a class cost of service study based on marginal cost in its next rate case.

### DISCUSSION

The Department argued that marginal costs provide useful guidelines for setting both class revenue responsibility and rates. DPS Ex. 99 at 14. In its Order in Otter Tail Power Company's 1986 rate case (Docket No. E017/GR-86-380), the Commission set out the following general discussion:

Marginal cost is the cost of producing one additional unit of a good or service . . . The difference between embedded and marginal costs is significant. An embedded cost study is based on historical costs, whereas a marginal cost study analyzes the cost of producing an additional unit of . . . service. Thus, a marginal cost study is based on current costs and is intended as a measure of the value of the resources needed to provide . . . service to customers.

DPS Ex. 99 at CO-15. The Residential Utilities Division testified in the instant case that:

proper price signals [established through marginal cost studies] mean that resources are employed in their best use, and that customer prices are set exactly at the value of the resources used in producing the good. The resulting allocation of resources results, in theory, in the greatest possible wealth for society as a whole, because no resources are wasted and consumers realize the greatest benefits possible without over-consumption.

OAG Ex. 94 at 3.

The Department noted that a number of issues would likely need to be resolved before the parties would agree on a definitive marginal CCROSS. DPS Ex. 99 at 14. However, as rates move closer to embedded cost, the more important it becomes to use a marginal CCROSS to refine rates. Tr. Vol. VI at 678. While embedded costs have historically provided general guidelines for setting rates, marginal CCROSSs are theoretically superior. DPS Ex. 99 at 3. Thus, requiring Minnegasco to file a marginal CCROSS in its next rate case would both facilitate the discussion on marginal CCROSSs and provide immediate information from a marginal CCROSS. Providing advance notice that this issue will be pursued in Minnegasco's next rate case would allow for more thoughtful analysis and evaluation, rather than attempting to use information requests with short deadlines to develop a complex proposal. DPS Ex. 99 at 12.

## 7. Minnegasco's Proposed Bill Format Change

198. The Judge finds that Minnegasco's proposal to change its billing format and request for an indefinite, continuing variance of related rules is improper and should be denied.

## DISCUSSION

Minnegasco proposed to stop showing any PGA information on customer bills. To accomplish this, the Company requested indefinite variances to Minn. R. 7820.3500, 7820.3600 and 7825.2700. Minnegasco argues that the PGA should not be shown because it confuses customers. The Department opposed this request for the following reasons:

A. To have better informed, more knowledgeable customers, customer bills should show the base cost of gas and the PGA.

B. Minnegasco redesigned its customer bills in the last rate case. There is no reason to change. Frequent change is confusing to customers.

C. As a matter of policy, the Department is opposed to indefinite rule variances. The Department argues that if there is a problem with the rule, the solution is to change the rule, not continuing variances. If the Commission determines a need to change its rules, a rulemaking process would allow broad input from a variety of sources - other companies, customers, and other interested parties. DPS Ex. 99 at 11.

The ALJ concurs with the Department. The Judge believes that it is doubtful that any State Agency is authorized to grant an indefinite variance from a rule. Regardless, the proper method for dealing with the problem is a rule change as the Department recommends.

#### 8. Energy CENTS Coalition's Recommendations

199. The ECC recommended that Minnegasco expand its low income programs by: implementing a percentage of bill plan; expanding the low-income discount rate; implementing an arrearage program; or offering a comprehensive customer assistance program. ECC Ex. 106, p. 3.

200. Minnegasco acknowledged that certain low-income customers have difficulty paying their bills. The Company believed, however, that there are many programs and services already implemented for low-income customers, including payment arrangements, discounted rates and administration and referrals for grants. MGC Ex. 41, pp. 96-97. Minnegasco asserted that those programs should be evaluated before any new program was initiated.

201. The Administrative Law Judge believes that the recommendations given by ECC deserve closer examination by the Commission. This is particularly true in the context of a revenue reapportionment as substantial as that being proposed in this proceeding. It is not in the public interest to wait to gauge the impact of impending or actual cost to LIHEAP funding. The ALJ recommends that ECC's proposals should be examined to determine which is appropriate for implementation on a pilot basis.

202. In its Initial Brief the ECC alleged that Minnegasco may be violating the Cold Weather Rule. ECC Initial Brief, p. 5. The ALJ finds there is no evidence in the record that supports this allegation.

### XIII. CIP TRACKER

203. The Company and the Department disagree over two aspects of the CIP tracker balance. The parties agree that the balance should be applied to or against the interim rate refund, if any, to the extent possible. Minnegasco believes that the balance used should be that existing at the beginning of the test year, updated to reflect the actual balance at the time final rates are adopted. Any excess, according to the Company, should be retained in rate base and amortized over two years. MGC Ex. 32, pp. 31-32.

204. The Department proposes that the application to or against the interim rate refund be based only on the beginning of test year balance, with no adjustment to reflect test year expenditures. Further, the Department urges that any unrecovered tracker balance be excluded from rate base, and that Minnegasco be required to seek an annual recovery mechanism for CIP expenses. DPS Ex. 84, pp. 2-3.

205. The ALJ finds that in Minnegasco's previous two rate cases both of these issues have been resolved in favor of Minnegasco's position. See Order, Docket No. G-008/GR-93-1090, dated October 24, 1994, p. 29, and Order, Docket No. G-008/GR-92-400, May 3, 1993, pp. 19-20. The Department has not presented any basis for departing from these procedures. The existence of a tracker requires that it be "zeroed-out" in rate cases, and no reason exists to use a number which by its very nature will not permit arriving at as close to a "zero balance" in the CIP tracker account as possible. Similarly, any excess balance will most readily be identified and recovered by including it in rate base and amortizing it over two years. This too will prevent an undue build-up in the tracker. The ALJ therefore determines that the tracker balance as of the time final rates are determined should be applied to or against the interim rate refund, and that any excess be included in rate base and amortized over two years.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

### CONCLUSIONS OF LAW

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this hearing pursuant to Minn. Stat. §§ 216B.16 and 15.47 - 14.62 and Minn. Rules Parts 14.5100 - .8300.

2. Any of the above Findings of Fact more properly considered Conclusions of Law are hereby adopted as such.



3. The Commission gave proper notice of the hearing in this matter, has fulfilled all relevant substantive and procedural requirements of law or rule and has the authority to take the action proposed. Minnegasco gave proper notice of the public and evidentiary hearings in this matter and has fulfilled all relevant substantive and procedural requirements of law or rule.

4. The quantum of proof necessary to establish the facts supporting the reasonableness of the proposed rate change is proof by a preponderance of the evidence.

5. The proper test year for use in this proceeding is the twelve month period between October 1, 1995 and September 30, 1996.

6. Through the structuring of the Offer as both a partial settlement and a stipulation of facts and recommended decision, the Offer complies with the Commission's request in its October 4, 1995 Order not to settle certain issues.

7. The settlement will produce just and reasonable rates regarding the issues settled and is in the public interest. The Commission's decision on the stipulated and disputed issues will not affect the reasonableness of the results of the settlement.

8. There is sufficient evidentiary support for the Offer.

9. The parties' agreement that amounts relating to advertising totaling \$220,343 be disallowed from FERC Accounts 9090, 9130, and 9300 is reasonable and should be adopted.

10. The parties' agreement that total marketing expenses should be reduced by \$1,069,150 is reasonable and should be adopted.

11. The parties' agreement on the general inflation factor to be used, resulting in a reduction of Minnegasco's revenue requirement by \$345,398, is reasonable and should be adopted.

12. The parties' agreement on changes in the inflation factors to be used on paper and paper-with-printing costs, resulting in a reduction in Minnegasco's revenue requirement of \$98,044, is reasonable and should be adopted.

13. The parties' agreement to have no inflation adjustment to telecommunications costs, resulting in a reduction of \$91,455 in Minnegasco's revenue requirement, is reasonable and should be adopted.

14. The parties' agreement to use the general inflation factor for software maintenance and tuition expenses, resulting in a reduction of \$33,918 in Minnegasco's revenue requirement, is reasonable and should be adopted.

15. The parties' agreement to use the general inflation factor for outside legal expense and advertising and marketing expenses and to not use an inflation adjustment for CIP expenses is reasonable and should be adopted.

16. The parties' agreement to use an adjusted normalized level of rate case expenses and to allow recovery of half of Minnegasco's unrecovered costs from the previous rate case as an offset to the interim rate refund, resulting in reductions of \$313,830 in Minnegasco's operating expenses and \$668,177 in the rate base, is reasonable and should be adopted.

17. The parties' agreement to allow Minnegasco to request a deferral of rate case expense in excess of the normalized level, with the concurrent understandings, is reasonable and should be adopted.

18. The parties' agreement to reduce Minnegasco's revenue requirement by \$110,773 for service technician expenses relating to gas leaks and winter leak surveys is reasonable and should be adopted.

19. The parties' agreement to adjust the sales forecast for the test year, based upon the actual number of Minnegasco customers served at November 30, 1995, resulting in a reduction of \$1,206,755 in Minnegasco's revenue requirement, is reasonable and should be adopted.

20. The parties' agreement on flowing curtailment penalty revenue to firm customers through the monthly PGA is reasonable and should be adopted.

21. The parties' agreement to remove the telemetry equipment and related expenses from the test year is reasonable and should be adopted.

22. The parties' agreement to reduce Minnegasco's revenue requirement by \$76,403 for economic development expenses is reasonable and should be adopted.

23. The parties' stipulation on the issue of service line and main extensions to reduce FERC Account 376 by \$949,561 and Net Distribution Plant by \$628,573 will result in just and reasonable rates.

24. The parties' stipulation that \$6,970,000 is the appropriate environmental clean-up expense for the test year will result in just and reasonable rates.

25. The parties' stipulation that the recovery of the costs of the low-income discount program be modified, resulting in reductions of \$31,500 to rate base and \$78,000 to operating expenses, will result in just and reasonable rates.

26. It is appropriate to conclude that adoption of the Offer (including both the settled issues and the stipulated issues) will reduce Minnegasco's operating expenses by \$3,619,016 and rate base by \$3,695,419.

27. The Offer is supported by record evidence, is reasonable and in the public interest, and should, therefore, be adopted in its entirety.

28. The MPGA identified no over-investment in Minnegasco's plant related to expansion projects and its recommendations on the service line issue should be rejected.

29. The OAG's proposal for treatment of the costs of the low-income discount program is not reasonable and should not be adopted.

30. The rate of return should be determined using Minnegasco's capital structure.

31. Minnegasco's stand-alone tax rate should be used in the determination of Minnegasco's tax expense.

32. An 11.0% return on equity should be used in the determination of Minnegasco's allowed rate of return.

33. Minnegasco's acquisition of the Minnesota properties of Midwest Gas produced no identifiable benefits to Minnegasco's ratepayers. Therefore, the acquisition adjustment proposed by Minnegasco must be denied.

34. Any recovery for Minnegasco's incentive compensation plans must be consistent with Findings in this Order.

35. Minnegasco's proposed use of an environmental tracker is reasonable and should be adopted along with its proposed Environmental Cost Recovery Charge ("ECRC"). The ECRC should be effective as of October 10, 1995, and should reflect the tracker balance, adjusted to reflect test year expenses of \$6,790,000.

36. The environmental tracker balance should not be subject to carrying charges.

37. The proceeds from the insurance reimbursement for 1991 environmental costs should be included in the environmental tracker balance.

38. The parties' agreement that the interim rates refund should be reduced by the unrecovered CIP tracker balance is reasonable and should be adopted.

39. The Company's CIP tracker balance to be applied to or against the interim rate refund should be as of the beginning of the test year, updated to reflect the actual balance at the time final rates are adopted. Any excess balance as of that date should be included in rate base and amortized over two years.

40. Minnegasco's proposal to include the utility-only related portion of its investment in, and expense of, its compressed natural gas fueling station is denied.

41. The exclusion of Minnegasco Exhibits 24 and 27 has been reconsidered and the previous decision is hereby affirmed.

42. Minnegasco's CCOSs were appropriately developed and are of a type consistently used by the Commission in the past, as evidenced by the previous approval of similar cost studies. Therefore, they are reasonable and should be adopted.

43. The Department's proposed revenue apportionment best satisfies the rate design goals found to be appropriate for this proceeding and, therefore, should be adopted.

44. The Department's proposal to increase the residential basic charge to \$6.00 per month is reasonable and should be adopted.

45. Minnegasco's proposal to increase the basic charge for C & I "A" customers is reasonable and should be adopted.

46. Minnegasco's proposal to eliminate the \$100 differential in the basic charge between LVDF transportation and sales customers is unsupported by the record and should not be adopted.

47. The Department's proposal to adopt seasonal rates is redundant, since seasonal variation already occurs, and is unlikely to affect customer consumption patterns. Therefore, it is not reasonable and should not be adopted.

48. The Department's recommendation that Minnegasco file a marginal cost study for informational purposes in its next rate case is reasonable and should be adopted.

49. Minnegasco's proposal to change the customer bill format should not be adopted and the requested variances should not be granted.

50. The ECC's proposals to expand the low-income programs should be examined to determine which would be an appropriate pilot project.

51. Based on all of the above Findings and Conclusions, a rate increase of \$13,960,000 is reasonable and should be granted to Minnegasco.

Dated this 12th day of April, 1996.

/s/ Allen E. Giles  
ALLEN E. GILES

Administrative Law Judge